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SALE OF CONRAIL

HEARINGS

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

SALE OF CONRAIL

FEBRUARY 27, 28, AND APRIL 4, 1985

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SALE OF CONRAIL

WEDNESDAY, FEBRUARY 27, 1985

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The committee met, pursuant to notice, at 9:30 a.m., in room SR-253, Russell Senate Office Building, Washington, DC, Hon. John C. Danforth presiding.

Staff members assigned to these hearings: Pamela Garvie, staff counsel and Linda Morgan, minority staff counsel.

OPENING STATEMENT BY THE CHAIRMAN

The CHAIRMAN. Today's hearing is the first of 2 days of committee hearings on Secretary Dole's recommendation to Congress that the Norfolk Southern Corp. purchase Conrail.

Such a purchase would mark the culmination of the long effort to end Conrail's ties to the Federal Government and return it to the private sector where it belongs.

Some of you here today will remember back when the effort got started. In the early 1970's, Congress ordered the consolidation of seven private sector railroads whose bankruptcies threatened rail service in the Northeast. On April 1, 1976, Conrail was created. With the expectation that Conrail would become profitable by the end of that decade, Congress invested heavily in Conrail's operations and capital.

Unfortunately, there were no profits to be had. In response to this, Congress passed the Staggers Rail Act in 1980 and, in turn, the Northeast Rail Service Act in 1981. These acts granted Conrail new rate freedoms and special advantages, including wage concessions, tax exemptions, and relief from operating unprofitable freight and commuter services.

At the same time, Stanley Crane, the head of Conrail, put into high gear the management skills which had earned him the reputation as one of the country's best railroad executives. This combination of factors finally netted returns.

By the end of 1981, Conrail posted its first annual operating profit, and each year since then the profits have been steadily increasing.

Based on Conrail's profitability and NERSA's directive to find a buyer for Conrail, Secretary Dole went to work soliciting offers for the railroad. With the able assistance of John Riley and her staff, and investment banker Goldman, Sachs, she contacted over 100 companies. She also looked at the possibility of a public offering.

The result was that she received 15 offers by last June to purchase Conrail. With that, she began a series of difficult, time-consuming negotiations in order to narrow the list of offerors. Further, she again looked at a public offering after Conrail's management submitted such a plan.

During the negotiations, she worked closely with a number of interested parties. She also went out of her way to keep Congress advised of her progress.

Today, we have before us the product of all that work. We have come far since the 1970's when Conrail was created.

Madam Secretary, I want to commend you and congratulate you for your determination and for the painstaking efforts you have put into bringing this recommendation before the Congress. I look forward to your testimony and I know other members of the committee do also.

Senator Pressler.

OPENING STATEMENT BY SENATOR PRESSLER

Senator **Pressler**. Well, I join in that. I want to commend our chairman, Senator Danforth, for initiating these hearings and also Secretary Dole and her staff and the other agencies who have done so much work to arrive at this proposal.

This is an extremely important and complex issue that must be studied very carefully before Congress makes a decision. I have declined to make any commitments on the proposal until we have a chance to hear from all parties concerned.

Indeed, according to one briefing we had, there is a feeling that a public offering would be more in the taxpayer's interest, and that this could—the present arrangement could appear to some as a sweetheart approach, but we need to consider that alternative very carefully in these hearings.

Also, another concern about the recommendation before us at this time is its potential anticompetitive impact. I understand that the Norfolk Southern has agreed to divest some of its lines in an effort to address this problem. I am interested in seeing exactly what lines we would be talking about here and what their criteria are for being considered sufficiently competitive.

It seems to me that the number of major railroads in this country continues to dwindle. I do not know whether this is another step in the direction of a one- or two-railroad country or not, but it certainly is a concern that I have.

Of course, I am also concerned about the impact that a Conrail/Norfolk Southern consolidation might have on certain Midwest railroads and shippers such as the Burlington Northern, Chicago & North Western, and the Soo-Milwaukee, especially as it relates to the divestiture issue.

Another area I will be paying particular attention to is the estimated abandonments and their impact on the local communities presently served. As a Senator from South Dakota, where we have seen many railroad abandonments that have had adverse impacts on the communities affected, I certainly empathize with this situation.

On the other hand, I believe the Norfolk Southern bid represents a strong financial case for its proposal. I also know that much thought and effort have gone into addressing the concerns I have. I will be particularly interested in having these and other issues addressed in the weeks ahead.

Let me say, Mr. Chairman, I have to chair another hearing later this morning, but I will be in and out, but I do want to compliment Secretary Dole and her staff. When I was in the U.S. House of Representatives many years ago, this was one of the first issues I voted on, and I am glad that Conrail has become profitable, and I think that we have reached a point that is basically very healthy, and I think we should be very careful of the next step.

Thank you.

The CHAIRMAN. Senator Pressler, thank you very much.

Senator Hollings.

OPENING STATEMENT BY SENATOR HOLLINGS

Senator HOLLINGS. Mr. Chairman, I appreciate it.

During the next 2 days, the Commerce Committee will be examining the recent selection by Secretary Dole of Norfolk Southern to be the purchaser of Conrail. This selection represents an important step toward transferring Conrail to the private sector and securing the future of rail freight service in the region that Conrail now serves. I commend the parties for their diligence over the last several months to this end.

In my statement at the committee hearings held in June of last year, I emphasized my concerns that in any sale of Conrail, we must be assured of a reasonable return to the Federal Government; a purchase that brings financial strength to the Conrail system; an arrangement that ensures the continuation of high-quality service in the Conrail region and as a link to other parts of the country; and a sale which recognizes the sacrifices that rail labor has made and the importance of labor participation to the future of the rail system in the Conrail region. I believe that the selection of Norfolk Southern represents an appropriate balance of these interests.

The Norfolk Southern is a carrier that has clearly demonstrated its ability in my State and the others that it serves to provide efficient and high-quality rail service. I am confident that Norfolk Southern would show the same commitment to high-quality service in the Conrail region. Furthermore, Norfolk Southern is a financially secure railroad that could bring important resources to rail service in the Conrail region, and could even enhance service in that region and as a link to the rest of the country. These factors are critical to securing the future of Northeast rail service in the private sector and, together with other elements of the bid, make the selection in my view a strong one.

I recognize the concerns that have been raised by various groups about a Conrail/Norfolk Southern combination—concerns which I and my fellow committee members will be examining in greater detail in the days ahead. In particular, various railroads have raised anticompetitive concerns with such a combination. I am interested in clarifying today what the Department of Justice concluded to be anticompetitive and how the proposed divestitures will meet these problems. Also, the questions of future traffic diversions and employment impact on other carriers have been raised by CSX and others. I am interested in securing more specific information on the nature of these impacts and on whether a Conrail/Norfolk Southern merger would truly result in significant erosions of competitive rail service in the East and other areas. I look forward to hearing from the Department of Transportation, the Department of Justice, Norfolk Southern, and affected railroads on these points.

In addition, we will be hearing testimony from labor representatives, Conrail management, and others in favor of a sale through a public offering rather than to Norfolk Southern or some other single entity. With respect to the public offering alternative, I am principally concerned about the feasibility and timing of such a railroad offering, the financial and operational protections that would be possible in a public offering, and the ability of a Conrail system to survive as a single entity in the future, particularly given the option of a combination with a strong carrier such as Norfolk Southern. In addition, I am particularly interested in the divergent views of rail labor, some of whom have expressed opposition to the Norfolk Southern selection and support for a public offering. I would be interested in knowing why certain labor representatives are opposed to a combination which could bring long-term strength to the Conrail system, a consideration clearly of importance to rail labor.

I have already indicated my willingness to work with Secretary Dole in this effort and will be joining Senator Danforth in introducing implementing legislation shortly. I look forward to working with the Department and other affected parties as we seek answers to questions that have been raised and progress through this process, which I view as critical to the future of private-sector rail service in the East.

I will simply state now that I had occasion to meet last week with Secretary Dole and go over this very important initiative and, having watched it from the early days when we first had to go in in order to save the rail service over the land, and then joining in the feeling that we ought to privatize it, I discussed various options from a public stock offering to the other bidders, to why didn't so and so bid.

Madam Secretary, I want to congratulate you. You impress me that you have done a very thorough job. You have done your homework and have a very valid and, to me, an acceptable proposal.

I have agreed to cosponsor the implementing bill, and I hope we can have our staffs continue to work on exactly that, on getting it in final form and submitting it. And I appreciate the work that you, Madam Secretary, have done, and intend now, unless we find something else remarkable that we haven't thought of, to support it.

The **Chairman**. Madam Secretary, you are joined by Mr. Kenneth Brody of Goldman, Sachs, who I understand does not have any prepared statement but is prepared to answer questions we might have. Also joining you is Mr. John Riley who will be with us again tomorrow morning to represent your standpoint.

Madam Secretary, thank you very much.

Excuse me, Madam Secretary. Senator Rockefeller is with us and this is his first meeting as a new member of the Commerce Committee. I am delighted to have him. I am sure we all are.

Senator HOLLINGS. If the chairman would yield, I would like to welcome him on behalf of the minority. I find that too often we in Washington, the congressional public servants, put a lot of weight and importance in: I introduced, I sponsored, I taught, I spoke, I introduced.

These Governors have to execute and administer, and when you can find an outstanding one like Governor Rockefeller come to the Congress with that past experience of having been given a program—you know, we in Congress love to get them through, but we never know what to do with them afterwards—having been given a program and then having to administer it successfully, which he has done, it is a wonderful privilege to have him serve with us on the committee with that experience and background.

And I want to welcome him, too, along with you, Mr. Chairman. Thank you.

Senator ROCKEFELLER. Thank you, Mr. Chairman and Senator Hollings. I won't respond to that. I hope the committee meetings will always proceed in this manner. I would be most pleased.

Senator HOLLINGS. You will learn to turn on the mike and make a lot of noise.

The CHAIRMAN. Senator Riegle, do you have a statement?

OPENING STATEMENT BY SENATOR RIEGLE

Senator RIEGLE. Thank you Mr. Chairman, and I would also like to welcome Secretary Dole to the committee. The hearings today and tomorow are the beginning of an important process to determine the necessity for the disposition of Conrail to Norfolk Southern or any other bidder or entity; the adequacy of the Norfolk Southern proposal and the covenants that DOT has attached to the contract; the return to the U.S. taxpayer; the extent of labor protections; and the long-term viability and preservation of competition in the Conrail regions of the country. An important corollary issue is how the proceeds of the sale will be distributed to the States to assist them in critically needed repair and renovation projects on rail systems within their borders.

Conrail is an integral part of the rail transportation network in Michigan. It carries a tremendous volume of auto-related traffic, both into and out of the State. It serves many of the auto plants in Michigan, and is also of great importance to manufacturers of other commodities, as well. It is not, however, the only railroad in Michigan, and we must consider the possibility that the sale to one of the bidders may actually result in less competition and choice for Michigan shippers. I don't want to see less competition or a reduction in any alternatives currently available to shippers.

I have not taken a final position on this issue. Each of the offers that has been submitted, as well as the public offering, has merit in its own right, but they also raise significant concerns. I am confident that the Secretary has tried very diligently to obtain the best terms for the Government, and am convinced of her commitment to maintain Conrail as a single entity long into the future. I know that she has worked very hard to reach this point, and look forward to working with her as the process continues. I would also like to acknowledge the important role that John Riley has played in this matter, and he, too, has pursued the sale with the purpose of maintaining the vitality and identity of Conrail and of preserving the entire rail transportation system in the country.

The CHAIRMAN. Senator Kasten has a statement for the record.

OPENING STATEMENT BY SENATOR KASTEN

Thank you, Mr. Chairman.

I want to express my admiration for the untiring efforts by the Secretary of Transportation in arriving at a decision on the sale of Conrail. The decision could not have come at a better time. The American taxpayer has yet to see one dollar repaid out of the millions of dollars that have gone to keep Conrail's head above water and its operations afloat. We must act in such a way here now in order to prevent a similar fiscal tragedy down the road.

With the aid of Federal incentives, Conrail has made a comeback. For this we are thankful. Many jobs have been saved in the process. I know the Secretary of Transportation has deliberated long and hard with much expert advice, to arrive at a wise and judicious decision. A public sale of Conrail, while serving the interests of some, would not be in all the people's best interest.

I want to carefully examine all new evidence that Congress may bring to light through these hearings. But frankly, I'm inclined to trust the Secretary's judgment on this difficult decision. We've heard a lot of overblown charges from all sides of this issue. Unless Congress can prove, to the contrary, that the sale of Conrail to Norfolk Southern would substantially reduce rail competition, increase shipping prices, curtail delivery service, and eliminate jobs, I will maintain my present support for the Secretary's decision to sell Conrail to Norfolk Southern.

Thank you, Mr. Chairman.

The CHAIRMAN. Secretary Dole.

STATEMENT OF HON. ELIZABETH HANFORD DOLE, SECRETARY, DEPARTMENT OF TRANSPORTATION; ACCOMPANIED BY KENNETH D. BRODY, PARTNER, GOLDMAN, SACHS & CO.; AND HON. JOHN RILEY, CHAIRMAN, FEDERAL RAILROAD ADMINISTRATION

Secretary DOLE. Thank you, Mr. Chairman. I certainly welcome this opportunity to appear before you today to discuss the plan that I have submitted to the Congress for transferring Conrail to the private sector after almost a decade of Federal stewardship.

In reaching my decision, I have kept in mind the sacrifices and security of Conrail's employees, the needs of its shippers, and the interest of its majority stockholder, the American taxpayer.

We have labored long and hard to reach a recommendation that will best serve not only the region, but the entire Nation. We have weighed all feasible options, Mr. Chairman, for Conrail's future, including the option of not selling it. We relied on the professional advice of our investment banker, Goldman, Sachs & Co. We consulted with congressional leadership and many Members of Congress individually, Federal agencies with expertise in relevant areas, and we talked with State and local officials from the region, employee representatives, shippers, Conrail management, Conrail board members, and other interested parties.

And I might just add, not just once, but many times around we have consulted and discussed the plans as we have moved along at each stage.

Finally, and most significantly, we have honored all the directives of the statute that governs the sale process, the Northeast

Rail Service Act of 1981. As contemplated by NERSA, this process will assure the return of Conrail to the private sector as a strong, viable railroad.

Given that Conrail is profitable, the statute requires the sale of Conrail as an entity through sale of its common stock, and further requires us to submit a plan that ensures continued rail service, promotes competitive bidding for Conrail stock, and maximizes the return to the taxpayer for the investment that has been made to preserve Conrail.

In honoring these criteria, I am recommending a sale plan that assures long-term rail service to the region, true employment stability for Conrail's work force, and a very high level of confidence that Conrail will never again become a ward of the Federal Government.

We can now give Conrail the opportunity to prosper as a truly private sector business and as a key part of a stronger company.

Let me briefly describe why I'm recommending Norfolk Southern as the purchaser. Conrail must be able to provide first-class service over the long haul, regardless of national or regional economic cycles. Accordingly, we analyzed which purchase offer would place the railroad in the strongest condition after the sale.

Among other things, we analyzed the financial strength of the offerors and financial projections for the combined entity. And that was done in each instance with regard to the final bidders. We looked at availability of financing and ability to carry resulting debt, specific plans for reinvestment, and minimum working capital levels.

Norfolk Southern's proposal is to pay a minimum of $1.2 billion in cash entirely out of its own pocket, a commitment not found in any other proposal.

The long-term strength of the company is essential to its shippers, the communities it serves, the people it employs, and the taxpayers who must never again be asked to bail it out. Any measure that would weaken Conrail financially threatens each of them. The sale to the Norfolk Southern would leave Conrail in the best possible condition.

In addition, we weighed each offer in terms of protecting service to shippers and communities throughout the Northeast. We looked in detail at reductions or enhancements of service that might result, including existing service commitments by Conrail.

The Congress is aware, of course, that the Justice Department also conducted an independent extensive analysis, a very thorough and painstaking analysis over 6 months of the impact on competition of the proposed sale to Norfolk Southern. And it set out a series of conditions to maintain competition that must be met before sale can be closed. And, of course, Justice will retain jurisdiction until each of those conditions has been met.

Under these conditions, the purchase of Conrail by Norfolk Southern will enhance competition in two important ways. The Norfolk Southern has pledged to reopen many gateways and reinstitute joint routes that are presently unavailable as a result of Conrail's actions and the divestitures, the opening of gateways, and the granting of trackage rights necessary to satisfy the Justice Department's requirements will strengthen the competitive position of smaller railroads in the regions served by Conrail.

And I might just add that Norfolk Southern had already talked to us about their desire to open some gateways and to reinstitute joint routes in many instances before the Justice Department made its review.

Viewed from another perspective, Norfolk Southern indisputably intends to remain in the railroad business.

Last, we favored the option that, consistent with these criteria, offered the maximum return to the United States. It would do no good, of course, to run up the price only to lose important service or risk reinheriting the railroad at some future date.

Nevertheless, we have a clear statutory mandate under NERSA to maximize the return to the taxpayers, and I believe that we have done just that with this proposal.

The Norfolk Southern Corp. will pay us a minimum of $1.2 billion in cash at closing, a minimum. The actual dollar amount will probably be higher, since the final purchase price is keyed to the amount of cash Conrail has on the day of closing.

Norfolk Southern will also surrender Conrail's accumulated tax benefits. That is $2.1 billion in net operating losses and $275 million in investment tax credits. This surrender of tax benefits represents true value to the Treasury and is a very important element of the total compensation.

Norfolk Southern has also agreed to be bound by a strong set of protective covenants that will safeguard the public interest for 5 years during the transition to private ownership.

And, Mr. Chairman, I feel that that is a key part of this proposal, the covenants, because indeed the financial strength of this railroad is crucial and these covenants are designed to go right to the heart of it.

All of these elements are part of the consideration that we will receive for the Government's 85 percent of Conrail's common stock. Those who focus solely on the cash portion of the consideration are overlooking major portions of the value for which we have bargained over these many months.

We might have received a higher cash price for the stock if we had been willing to forgo the protective covenants. In fact, I am certain we would have. Controlling stockholders are not generally accustomed to the sorts of restrictions that we have negotiated with the Norfolk Southern, but I believe they are essential, as I have said, to the public interest.

The covenants will preserve quality service, protect Conrail shippers, and ensure continued financial strength. The covenants require Norfolk Southern to operate Conrail as a system much as it is today. Norfolk Southern has agreed to invest hundreds of millions annually in Conrail's physical plant, and to refrain from deferring maintenance to any level below Norfolk Southern's own standards which, Mr. Chairman, are the highest in the industry.

The covenants require Conrail to refrain from paying dividends on the common stock unless $500 million in cash would remain after those dividends are issued. Norfolk Southern is bound by the covenants to maintain its controlling ownership interest in Conrail for 5 years. Conrail's expedited abandonment authority will be relinquished, and any lines that are abandoned will be offered to shippers or short line railroads at 75 percent of net liquidation value.

All of Conrail's current minority business enterprise and equal employment opportunity programs will be continued. Conrail will maintain its headquarters in Philadelphia and will continue to operate the Altoona shops.

All of these covenants will last for 5 years and are enforceable by Federal court injunction. And I might just add, there are criminal penalties for any false statements that might be made.

There were other approaches suggested for Conrail's future than those of the three final bidders, as you know. And I would like to speak for a moment about recommendations that the sale be delayed in the hope that we might get a somewhat higher purchase price.

In my opinion and that of our investment adviser as well, a better opportunity will never arise. We solicited offers in good faith, and we were rewarded by a wide range of credible offers by serious bidders. The bidders believed we intended to sell a railroad. Conrail's contract employees have also treated the sale process seriously, dealing constructively with each offer presented, and making their own offer as well.

Since passage of NERSA in 1981, Conrail has become profitable at no small cost in time and effort. State and local transit agencies took over commuter rail operations under NERSA's directive. Conrail's employees made significant wage concessions, and the States in the regions have sacrificed tax revenues from Conrail totaling more than $25 million annually.

A public offering of Conrail stock also has been suggested. At my request, Goldman, Sachs considered a public offering early in our deliberations; in fact, back in the spring of 1983 we looked at the pros and cons of the public offering. Goldman, Sachs advised me that there were practical difficulties and substantial risks.

Thus, I used the competitive bid approach and I conducted extensive negotiations simultaneously, as you know, with six bidders and then with the three finalists.

Last month, some members of Conrail management submitted an offer based on a public offering. Again, I asked Goldman, Sachs to review it. Measured against the criteria that I had established, they advised me that the Conrail management proposal is less advantageous than the Norfolk Southern bid in a number of respects.

Let me review those quickly:

First, the management plan takes a minimum of $300 million in cash out of the company, regardless of its cash position.

Second, the management plan forces the company to issue $600 million in preferred stock. In fact, Mr. Chairman, this would be the largest preferred stock issue in American history. In contrast, Norfolk Southern's proposal does not involve any preferred stock.

Third, the management plan clearly violates the dividend covenants that Norfolk Southern has accepted. Based upon Conrail management's own projections for the 1985–88 period, the dividend covenant would allow a total of only $60 million in dividends on common stock. The management plan requires combined common and preferred dividends of $126 million per year, and it would require increased borrowing by Conrail over the next 4 years of $400 million.

Fourth, there is no indication that a firm commitment would be offered by Morgan Stanley or anyone else to underwrite the management public offering plan. I have only been given estimates, opinions, and predictions. If the market is unable to absorb $500 million in common stock and $600 million in preferred stock in one offering, then either the Government or Conrail will absorb the short fall.

Since there has been only one initial public offering of over $300 million by an industrial company in American history, the risk is very large. Yet, that one offering by the Ford Motor Co. in 1956 had many advantages that a Conrail offering would not have.

Fifth, despite optimistic estimates made by some that we can get much more for Conrail through a public offering, the management plan only proposes to raise $1.1 billion at best. Again the balance is to be paid out of Conrail's treasury. In considering the market value of Conrail's stock, we must remember that Conrail has a short history of profitability. Although Conrail reported about $500 million in earnings last year, much of that amount is attributable to special contributions or benefits conferred by the Federal Government, by Conrail's employees, and by the States during the time that Conrail has been federally owned.

Conrail would not earn nearly as much in private hands because none of those contributions or benefits will be available. Conrail pays no State taxes. The States, therefore, are making in effect a $25 to $26 million annual contribution to Conrail's profits.

Conrail pays no labor protection. The United States makes that contribution to Conrail profits, ranging from $125 million to $23 million over the last 3 years. Until last week, Conrail paid its workers between $120 and $130 million less than they would earn if Conrail had been at national scale, and that goes right into the company's profits.

Conrail has been paying no Federal taxes, and that saving goes toward profits as well. Clearly, Conrail will be far less profitable in private hands than might appear at first glance.

It is obvious that the combination of Conrail and Norfolk Southern is stronger than Conrail standing alone. Conrail alone cannot shoulder a major acquisition debt or new stock issue.

I have made what I truly believe is the best recommendation for a strong Conrail in the future. Congress now has the important role to play. The Congress must weigh the recommended offer and make the ultimate judgment as to whether or not it should be accepted.

I will shortly be transmitting a legislative proposal to the House and to the Senate that would make the technical changes needed to accomplish this sale. Our legislative proposal will assure that Conrail will be treated like any other private sector railroad and the Government's investment and role in Conrail will be fully terminated to assure that we do not reinherit the railroad in the future.

In conclusion, I urge you to act swiftly to evaluate the plan and to report the legislation needed to consummate a sale. Four years ago, Congress gave us the opportunity to start down this path of taking the Federal Government out of the railroad business. I have made the utmost effort to find the best possible buyer for this railroad. If we unduly hesitate, this historic opportunity may be lost.

Mr. Chairman, that completes my prepared statement, and I would certainly be happy to respond to questions at this time.

The **Chairman**. Madam Secretary, thank you very much.

Mr. Brody, I would like you to, if you would, address yourself now to the sale. Obviously, when there are 15 bidders at the outset, there are going to be 14 disappointed bidders. In addition to that, some people have suggested the possibility of a public sale.

I know that your firm of Goldman, Sachs has analyzed the possibility of a public sale. I would imagine you have read the letter from Morgan Stanley stating their view that a public sale would be feasible.

Could you give us your judgment as to whether the Norfolk Southern sale is the best deal from the standpoint of the Government and from the standpoint of the future of rail transportation in the Northeast? Also, could you advise us whether you think that the Norfolk Southern sale is better from the standpoint of both the Government and rail transportation than would be a public offering. Finally could you advise us whether the idea that Senator Heinz has put forward, namely, to try a public offering and if it fails, then culminate the deal with Norfolk Southern, makes any sense?

Mr. **Brody**. Thank you, Mr. Chairman, for the rather extensive question.

Let me start out by saying that Goldman, Sachs has been acting as the financial adviser to the Department of Transportation and our expertise is in the financial areas. Some of the aspects of the question that you touched on really go beyond the financial areas.

So if I may, I would like to limit our response to our area of expertise, which I think should cover most of the aspects of your question.

And let me try to break it down into a few components, one component being, is the $1.2 billion a fair price? The second component is how does the public offering scenario weigh in against the Norfolk Southern proposal? And the third component being a comment on the financial strength of Conrail alone as compared to the combination of the Norfolk Southern and Conrail.

And at the risk of sounding too commercial on the part of Goldman, Sachs, let me just take one quick sentence to set forth some of the qualifications that Goldman, Sachs has to provide this financial expertise.

In addition to being the leading underwriter on Wall Street with respect to lead managing common stock offerings of industrial companies over a long period of time and in addition to being the leading trading firm in common stocks to institutions, we have had the benefit of the advice on our team of my partner, Michael R. Armellino, who has been voted, year in, year out, by very large margins, by the Institutional Investors of America as the leading railroad analyst.

So we feel that our judgments have a lot of expertise behind them.

The point of value. We are absolutely clearcut in our minds and so have advised Secretary Dole that the offer that Norfolk Southern has made is, in our view, a fair offer. A competitive bidding process produced the price. Over 100 potential buyers were approached. If there were a purchaser who thought Conrail was being sold too cheap, he would have entered the bidding with a higher price.

No such purchaser with a firm commitment has done so. The people who have talked about higher prices and about Conrail being sold too cheap have not backed up their talk with money. And in the marketplace of determining values, it is real offers, backed up by money, that count.

Furthermore, without going into the analysis, the numbers support the value, and the Secretary went through some of the analysis of the numbers, demonstrating that the $500 million reported in net income would have a significant detriment to it, once Conrail were in the private sector.

On the public offering, there are a number of points to be made. The first point is that the public offering proposal is just a proposal. It is not a firm commitment. Although talk of a firm commitment has been around since the middle of December, no such firm commitment has been produced. We have not had even the production of the conceptual outlines of a firm commitment.

So until we see something on the order of a firm commitment, we must conclude that it does not exist and that the public offering proposal is a proposal that is based on an underwriter's judgment. It is very, very different from the firm proposal from Norfolk Southern.

Second, I would comment on the public offering scenario, that whatever somebody's judgment is today, that judgment is based on the marketplace today. It is sure that if there were a public offering, whenever it would come, the market would be different, and that different market would result in a different value, whether that value be up or whether that value be down.

The next point about public offering is indeed there are a lot of uncertainties about the ability to consummate a public offering of the magnitude contemplated by the Conrail management and Morgan Stanley proposal. We're not saying that it can't be done; we are just saying that there are significant risks in it being able to be done.

Furthermore, with respect to the price to be achieved by the public offering, the Conrail management proposal indicated raising $1.1 billion in the public marketplace and $300 million from Conrail's cash, to give $1.4 billion to the Government. While that is in the range of feasibility in today's marketplace with an unfettered Conrail, it is our judgment that such a proposal would not be achievable in today's markets if Conrail, in the public offering scenario, had to live with the protective covenants that Norfolk Southern is giving to it.

We wrote a letter on this topic to Secretary Dole on January 24. I think it is fair to update our thinking since then. And our thinking on the change in the marketplace between January 24 and today is that the marketplace would be somewhat less receptive today than it was on January 24, primarily because of the climate introduced by the recent run-up in interest rates and a number of other factors affecting the rail business.

While I wouldn't want to overplay that, I would just say that where we are today relative to January 24, we think the market is marginally worse.

A comment on the financial strength of Conrail. One needs to go beyond the existing numbers that Conrail has and apply some element of common sense in taking a look at Conrail as a stand-alone entity in order to have some notion of the kinds of risks that are presented by Conrail alone. The facts are clear. Conrail operates in a region which has had a history of bankrupt railroads. Conrail has had a significant and continuing decline in traffic over a long period of time.

Conrail's projections for traffic up through 1988, only get the traffic level in 1988 back to where it was in 1984. And based on history, that may be optimistic. The management, working under the deregulation provided by the legislature and with the cooperation of labor, has done a terrific job in getting this railroad on a profitable basis. But it is pretty clear that one can't save your way to prosperity.

What these general facts lead us to is that although it is not quantifiable, there certainly is reason over the long term to have an element of concern about the long-term financial viability of Conrail. It is absolutely clear, without a doubt, that the combination of Conrail and Norfolk Southern produces a significantly stronger entity. And to the extent that the facts that I just mentioned causes concern with respect to the financial viability over the long term for Conrail, then it should weigh very strongly in one's mind that the combination of Norfolk Southern and Conrail is a much stronger financial entity.

The **Chairman**. Thank you, sir.

Senator Hollings.

Senator **Hollings**. Madam Secretary, I think that yours is an outstanding statement. You have covered, and Mr. Brody has just about covered, the real misgivings about other options--we have heard much in the media. I have tried to hold back making a judgment with respect to Philadelphia and our colleagues from Pennsylvania and everything else of that kind, and also about why not to sell it by a public offering?

I think Mr. Brody has covered it pretty well. But let me go right to Mr. Brody and then maybe a little backward.

When you say you can't save your way to prosperity, Mr. Brody, has it been the experience over the several years under public management that Conrail has been able to save, save, save but that, let's say, under a private approach, conrail could not exact these savings?

Elaborate on your statement that you can't save your way to prosperity.

Mr. **Brody**. The comment was really made to address two conditions. One condition is over a very long period of time, Conrail's traffic has been on a decline.

The second comment is that a substantial portion of Conrail's turnaround has come about because of the sensational job done by management in basically operating the railroad more efficiently.

However, the concern comes when you realize that you can't continue forever making operating improvements. And if the traffic continues to go down, at some point that must cause concern about creating a financial bind.

Senator HOLLINGS. Madam Secretary, with respect to the employees, I understand under the excellent management of Mr. Crane, that there has been quite a contraction of employees. And would you comment on that for me, please? And then how many jobs you think will be lost under the Norfolk Southern bid?

Secretary DOLE. Senator Hollings, that is true that the numbers have been decreased from about 100,000 employees back in 1976 when Conrail was established, when it was put together, to about 37,000 today.

Senator HOLLINGS. So it's gone from 100,000 down to 37,000 over that 9-year period.

Secretary DOLE. That is all employees. Right. And the merger of Conrail and Norfolk Southern would produce less in the way of affecting jobs—I would say less than half of the normal yearly attrition of the two systems combined.

In other words, if you combine Norfolk Southern/Conrail now, you would have less than half of their yearly attrition affected under this merger. And basically, I think it would come to something in the range of about 1,200 employees, and it would be by attrition, of course, overall.

Senator HOLLINGS. Only 1,200. Now, with respect to the size of the railroad itself, let's assume that it has been sold to Norfolk Southern. Conrail and Norfolk Southern—how does the size of that entity, generally to a lay person like myself, compare to its competition?

Secretary DOLE. It would be about 30,000 to 32,000 miles of track. Conrail is now—let's say Conrail is about 14,000; Norfolk Southern is about 18,000 I believe. So it would be somewhere in the area of 30 or 32, but there would also be 1,200 miles of track divested to the smaller railroads. And this, we feel, is not just a matter of preserving the competitive picture as it is; in other words, to assure that there there is no lessening of competition.

But we also see that having a procompetitive effect because of the opportunity to strengthen the smaller railroads involved and to open up gateways, to give them additional traffic.

Senator HOLLINGS. And what would be the size, then, of Norfolk Southern as compared to other railroads in this country?

Secretary DOLE. CSX, I believe, is the second largest now. CSX, by the way, is about 26,000 miles, I believe. So this would be slightly larger, then, than CSX.

I might add that CSX revenues last year were $7.9 billion and the combination of Conrail and Norfolk Southern last year, revenues were $7.5 billion.

Now, as far as placing them within all railroads in the country, I will ask the Federal Railroad Administrator if he has a statement on that.

Mr. RILEY. Senator, the combined railroad would be the longest in miles, but not the largest in revenue; comparable in size to the Burlington Northern, comparable in size to CSX. Today, CSX is the largest railroad in the East, 26,000 miles, 8,000 miles larger than Norfolk Southern. And Conrail is at 14.

And as the Secretary said, after this merger, Norfolk Southern and CSX will be comparable in length. The CSX Corp. will be slightly larger in revenues.

Senator HOLLINGS. Do you know why CSX didn't make an offer?

Secretary DOLE. CSX suggested that the railroad should be broken into two parts. And CSX, from early days, has expressed disfavor—they were not in favor of the Norfolk Southern bid or the Marriott bid, the Alleghany bid, or the public offering. Their position has been against each of those proposals.

They, in fact, did favor breaking up the railroad. Now, obviously, with 15 bids having come forward, 15 bidders on Conrail, I am not in a position to consider that, nor would you want me to consider that. I have heard no interest whatsoever in moving in that direction, and obviously that would produce—I think the effect of something of that sort would mean in many instances higher rates and other disadavantages.

So that is just not an option. But that is the plan that CSX has favored from the beginning.

Senator HOLLINGS. Do you know of any unfair—well, I will just get this one, please, Mr. Chairman, on my time—any unfair competition—of course, CSX is a very responsible and a good constituent of mine.

You hate, in politics, to make choices between constituents. But in looking at the overall public good, I am convinced right now, unless I change my mind, that this proposal is for the overall public good—but I want to ask any hostile question I can think of. Does this put CSX in an untenable position competitively? Would this unfairly burden CSX, where they had been running a good railroad and made this $7½ billion in profits and everything else? Does this put them in an anticompetitive position?

Secretary DOLE. I can't imagine that that would be the case, Senator Hollings. And the Justice Department, of course, has looked at this very thoroughly, an exhaustive review. Justice talked with CSX, I think, over a period of days about their particular issues and the points that they wanted to bring up.

And I might just add that I also respect their management and consider them good friends as well, and I have spent quite a bit of time with Hayes Watkins and John Snow and others, talking about the impact on CSX, and they have explained from early days what their position would be.

And ther is one item that we might address here, and that is that there has been a threat that the B&O might have to be abandoned, and there would be a layoff of about 6,000 employees. Now, you can't just abandon lines if you feel that you are inclined to do so. You can't simply abandon thousands of miles of lines.

Last year on the B&O, the tons of freight carried were 98.7 million tons of freight. I don't believe that ICC standards for abandonment could be met with that kind of carriage of freight. And indeed, if there were ever such a move, I can asssure you that railroads would be lined up to snap that up in a moment, in terms of the lines that they have suggested might have to be abandoned.

So I simply don't see a problem there, and they certainly, of course, are going to speak up on this, but I believe that their initial proposal is one which would not have been appropriate at all in the public interest.

Senator **Hollings**. I thank you, Mr. Chairman. I have some other questions I would like to ask.

The **Chairman**. We will have a second round.

Mr. **Riley**. Senator, let me add one thing. Since the press conference where the issue of the possiblity of CSX threatening to abandon the B&O was raised, I have had four separate inquiries on the purchase of the B&O.

The **Chairman**. Senator Rockefeller, no questions?

Senator Trible?

Senator **Trible**. Mr. Chairman, let me say that I am in the unenviable position of representing a State that is proud to be the home or the headquarters of two mighty transportation giants, Norfolk Southern and CSX, and so I find myself much in the same position as Senator Hollings, where I will be forced to choose between friends and constituents.

But I find your presentation this morning highly persuasive, Mrs. Dole, and the concerns that I had have been addressed by you and your colleagues this morning, and also in the answers to the questions of Senator Hollings.

I am not persuaded that a public offering is the right course, and I was concerned about the impact that this merger might have on the operations of CSX, and you have touched on that. And perhaps we will need to focus more on that.

But everyone agrees that we should divest ourselves of this railroad and turn it over to the private sector. The Government ought not to be in the business of running railroads. And we need the revenues desperately.

So I hope that we can make some hard decisions and move ahead promptly so that the railroad can be returned to private hands and we will have the benefit of those revenues as we attempt to tackle this huge deficit.

Thank you, Mr. Chairman.

The **Chairman**. Thank you, Senator Trible.

Senator Long.

Senator **Long**. I think you have made a fine statement here, and you have worked very hard on this. Now, you know so much more about this than I do, that I really need to be brought up to speed.

Secretary **Dole**. I don't know about that.

Senator **Long**. You say at the close of your statement: "I urge you to act swiftly to evaluate the plan and report the needed legislation."

Is it your thought that the Congress should act on this in the usual legislative procedure, or that we should try to use some other method to approve this legislation?

Secretary **Dole**. No. I am hopeful that with the 2 days of hearings, that the Senate can move swiftly. And I think that would be a strong signal to the House of Representatives, and I would hope to see the House move through hearings. I have been assured that the hearings on the House side would be fair hearings, and in light of that assurance I would hope that we could move forward with the process and discuss it fully, and answer all the questions, hopefully, and be able to see this move with all due speed, because the process has been a very full and lengthy one, Senator Long.

We have spent months negotiating these deals, and I think at this time everyone is ready to certainly give full attention to addressing all questions, but to see it come to fruition quickly, so that finally the employees will know what their future is going to be. Indeed, the States will begin to get their taxes again, and we can resolve this matter and go on to other important transportation issues.

Senator LONG. Let me just get this in perspective now. How long have you been working on this thing, Ms. Dole?

Secretary DOLE. Since I arrived at the Department of Transportation, Senator Long, which was just over 2 years ago. But the Northeast Rail Assistance Act in 1981 called on the Secretary of Transportation to develop a plan to retain an investment adviser to move forward to return the railroad to the private sector.

Goldman, Sachs was on board before I was in 1982.

Senator LONG. Since when?

Secretary DOLE. Goldman, Sachs came on board in 1982. And then in 1983, in February, I became Secretary, and it was the spring of 1983 that I asked Goldman, Sachs both to analyze the public offering or the route of going public offering, and also to go out and talk with a number of both rail and nonrailroad corporations that would be in a position, have the resources to have an interest in Conrail.

And then the first offer came in that summer from RLEA, from Rail Labor Executive Association, and John Riley and Ken Brody at my request in the fall of 1983 went out again and talked with over 100 railroad and nonrailroad corporations. Then the bids began to come in in the spring of 1984. And it's been since that time, June 18 was the date when all bids were to be on the table, because there had been a great deal of discussion about potential bid proposals.

But at that point in time, Goldman, Sachs advised me, after the Allegheny bid came in April 1984, to have a date at which time all bids would be on the table so that we could see exactly what was really going to be the potential purchaser.

Senator LONG. Let me ask you, are you going to ask or suggest that this matter be passed in the reconciliation bill?

Secretary DOLE. Well, I understood your question earlier to be aimed in that direction, and I hope that I answered it sufficiently by saying that I do hope that with full hearings on the Senate side, we can then send a strong signal to the House to move quickly to have hearings, and I have been assured that those will be fair hearings, in which case we will go forward and have full debate and discussion and hopefully see it resolved in that manner.

Senator LONG. Let me ask another question. Are we going to be asked to pass this bill as a reconciliation bill?

Secretary DOLE. The intention is not to do so, Senator Long.

Senator LONG. Because I personally feel that this measure might be passed in the ordinary legislative process. It is a significant measure, and I think that we ought to act on it.

Secretary DOLE. There is no intention at this time of doing so.

Senator **Long**. I have worked with administrations in the past, and in fact I have been a part of the leadership upon occasion, and I know the experience of having my leaders and executive branch say that we worked hard on this matter, that it has taken years to work it out, that there is no reason why Congress needs to give it much further consideration, and that this bill ought to be passed within a week.

Now, I would hope that we are not going to be asked to pass a bill so rapidly that we don't get a chance to give it thoughtful consideration and free debate.

Secretary **Dole**. I think there should be certainly that thoughtful consideration and opportunity for debate and discussion. But I would also urge that it be done expeditiously in terms of having it at the top of the priority list, because I do feel that already there has been extensive discussions.

I have met with all of you a number of times, and basically, you know, our discussions have been an ongoing dialog over many, many months. This is not the first time that the Congress has heard of this.

And each step of the way, before we set the June 18 deadline on, after the 15 bids came in, when I reduced them to 6, when I reduced them to 3, all along the way, I have been consulting with the Congress. So there has been a real process underway, and I would hope that that would provide a foundation so that this can be done without delay.

Senator **Long**. Well, I don't have any complaint whatsoever about the process, and I don't believe, up until this point, that you do, do you? It seems to me that the matter has been dealt with properly and that the hearings have been properly arranged. I would think that no one is going to have more influence in deciding what the schedule of this legislation will be than Bob Dole. And I think that you have some influence with him.

Secretary **Dole**. The problem is, Senator Long, you see much more of him than I do. So maybe you will talk to him about it.

Senator **Long**. Thank you very much, Mrs. Dole.

The **Chairman**. Senator Packwood.

Senator **Packwood**. Mr. Brody, I have two questions, and don't use up all my time in answering the first one, if you would. The argument is made that the biggest sale we have had with an initial public offering is $300 million, that was Ford Motor Co. The argument in contrast to that is made by those who want a public sale. They say: Great Britain just sold British Telecom, an infinitely bigger sale than this, they were able to handle it; therefore, we can handle a public sale in this country of a smaller magnitude.

What is the argument against that?

Mr. **Brody**. I think the argument is easy to make that British Telecom absolutely has no relevance to the sale of Conrail.

Senator **Packwood**. That is a good answer.

Secretary **Dole**. It's apples and oranges.

Mr. **Brody**. British Telecom was sold at approximately 50 cents on the dollar and was marketed very heavily; that is, it was sold and the price almost doubled overnight. I would contend to you that if you wanted to sell a lot of stock of anything, and told people they were going to pay 50 cents on the dollar, and you marketed this very heavily and very cleverly, that you could sell an awful lot of it.

Senator PACKWOOD. What you are telling me is the British Government wanted to get out of British Telecom and they were happy to get out even at a loss of its actual value, just to get out.

Mr. BRODY. They sold it at a substantially lower price. Second, British Telecom isn't Conrail. British Telecom is in telecommunications, tremendous growth, virtual monopoly. Conrail is in an area with significant decline in traffic over a long period of time, and has substantial competition from the truckers. It's just apples and oranges both in terms of businesses and in terms of trying to sell a company at close to value.

Senator PACKWOOD. That is a much better argument than I have heard from others who have attempted to say that if you could sell British Telecom in that market at its value, you could sell Conrail here, that we are a big enough country to absorb it.

You are simply saying sure, we are a big enough country to absorb it in a public sale; it just isn't the same thing.

Mr. BRODY. Right.

Senator PACKWOOD. OK.

Second question. We got $1.2 billion cash in hand from Norfolk Southern, and who knows what in these tax credits that Assistant Secretary Pearlman is going to testify on a little later. But let's assume they might mean a loss to the Federal Government of $300 or $400 million in tax revenue, if they were exercised by somebody. And Norfolk Southern is giving them up.

Without regard to all of the other very favorable arrangements that I think Secretary Dole has made that don't relate to cash to the Treasury, the divestiture, the payment to employees, a variety of other things, has any stock brokerage house, combination, syndicate, or anybody else come forward and offered to guarantee the underwriting to the Federal Government and say we will pay the Federal Government $1.5 billion, regardless of the outcome of the sale?

Mr. BRODY. No such institution has come forward with such a firm commitment. It has been talked about; it has not been delivered. And in fact, there was at least one financial institution who was among the 15 bidders, who tried to put together a package of such a firm commitment, and did not deliver it.

Senator PACKWOOD. And isn't it true that in the business you are in, it is a very unusual situation where Goldman, Sachs or a combination of brokerage houses will actually guarantee to a seller of stock a large sale, a fixed block of money, and say we will take all the risks; don't worry about a thing; we will guarantee you the figure. That is not normally the way you underwrite large, large stock offerings, is it?

Mr. BRODY. It is not done.

Senator PACKWOOD. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Riegle.

Senator RIEGLE. Thank you, Mr. Chairman.

Secretary and Mr. Riley particularly, I appreciate all the hard work that has been done over a period of time. We have had the occasion to meet and talk at length privately on these issues, and so I will not today go over the issues we have already had the chance to discuss.

But I want to say that my own mind is open on the proposal at this time. I have not made a judgment on it, and I am very much interested in not only your further testimony today, but that of other witnesses as well.

And I want to go right into the issue of how this is likely to impact in my State, which is a very large industrial State, as you know, and has very important relationships with Conrail and rail service, particularly as it relates to the automobile industry.

So I am concerned about the implications of the sale on competition and services in Michigan, particularly as it relates to the auto industry. Ford Motor Co., for example, as you probably know, spends about $1 billion a year on rail service and about $300 million of that is spent on the Conrail system.

I know that Ford supports the Norfolk Southern proposal presently, but I have not heard yet from either General Motors or Chrysler.

My question is this: Can you guarantee that shippers in Michigan, manufactureres as well as auto companies, will have the same choices of rail service after a sale to Norfolk Southern as they have available to them today?

Secretary DOLE. Senator Riegle, I think they will have more opportunities for service, because there will be two—for example, in Detroit, there would be two new ones, the P&LE and the Guilford, plus CSX, plus Grand Trunk.

So I think that what you have there is a stronger network than if this were not to go forward.

Senator RIEGLE. Well, let me pursue that because I've heard that, but I have some concerns about it, and I want to make sure that we really track that all the way through to the end.

I understand that Norfolk Southern would be required to divest themselves of certain routes in order to mitigate the anticompetitive concerns that have been raised by the Justice Department. And it appears as you say that Pittsburgh and Lake Erie and the Guilford system would acquire these routes and gateways and the Grand Trunk Western would not.

And I am, of course, very concerned about the viability and vitality of the Grand Trunk Railroad, and I am wondering what steps you have taken or would intend to take to ensure that the Grand Trunk is not put at a competitive disadvantage as a result of this sale, especially if they don't acquire any additional routes or gateways.

Secretary DOLE. Let me describe what has taken place to date with regard to the Grand Trunk. Grand Trunk Western, of course, they developed with P&LE a joint venture called ProRail. They came forward with this proposal and the Guilford system also was, of course, interested in bidding, and what has occured is not only that Guilford has completed their negotiations with Norfolk Southern first, because they did just announce a couple of days ago an agreement in principle with regard to acquiring the divested lines, and the P&LE as well has been a part of that.

But what happened is that there was interest—we wanted to give all of them a chance. I felt very strongly that rather than divesting just to one small railroad, we should try to bring in as many as possible, make this a procompetitive opportunity in terms of strengthening small railroads, opening up gateways, and providing for additional lines and so on.

The Grand Trunk Western was really not interested in—or at least this is what they have said—in becoming a part of that kind of shared opportunity. They put their proposal in the hopper, so to speak, by saying this is nonnegotiable; we are not interested in dividing it with the Guilford. In fact, they wanted hundreds of miles of additional track that was not a part of what the Justice Department had required to be divested.

So that's the situation; that at this point in time, I think the Guilford is certainly willing to continue to talk with Grand Trunk to move toward accomplishment of some of the goals that they wanted to achieve, but there has been an unwillingness to work with the Guilford to put together a system in which all three would share.

Now, the P&LE then broke off from the ProRail joint venture and made their own deal in concept, agreement in concept. But I don't think it is a matter of the Grand Trunk Western not having had every opportunity, and indeed we, as I say, prefer to have as many as possible participating.

Senator RIEGLE. Well, I am concerned myself about how viable the Guilford and the P&LE really are. Their immediate past record isn't that strong, is it? Haven't they had some real difficulties?

Mr. RILEY. Senator, the Guilford system is significantly stronger, both in its capitalization and its—and it is, in fact, profitable—than the Grand Trunk is. We are confident, having looked at the traffic flows of both of those carriers, that they can indeed support the service.

And let me add that the book is by no means closed on this. The requirement that the divestitures be to the small regional railroads did not come from Justice Department. It came from our Department, because the Secretary believes, and I did, that it was a onetime in a lifetime opportunity to create permanent competition by strengthening the small rail carriers.

Now, what happened? We were required by Justice to sit in and watch the negotiations. So I had a spectator seat in this. Three potential purchasers came forward to the Norfolk Southern and asserted their interests. In two of the cases they were able to negotiate an agreement, come to a deal.

The Grand Trunk took a nonnegotiable position that conflicted in two ways with Justice's demands. First, they required that additional Conrail lines, several hundred miles of additional Conrail lines be divested. That would have hurt Conrail and it would have created a new competitive issue in Michigan because they wanted to divest the Detroit to Chicago line that runs across the middle north part of the State.

Had Conrail been taken out of that region where Grand Trunk now operates, Grand Trunk would have been the only carrier in a very, very large area. We could not create a new competitive issue.

But the Guilford has made it clear that they are prepared to give Grand Trunk what it needs, which is access to Chicago in a fast route, and access to St. Louis, to the St. Louis Gateway. And I am optimistic that that can be worked out, and we are still working on it.

Senator **Riegle**. Well, I hope you are right. I've got some additional questions related to that, that I would like to submit to you for the record, and also I would hope that if you have not commented on it before—my bell just rang, as you heard—you comment on what I think is important to get a reading on—the current status of discussions with rail labor.

I know they appear to have in a sense changed their view recently, and if you have not discussed that at length, I would hope you would take the occasion to do so, not necessarily right this second, but before you leave the witness table so that we are up to date on that.

The **Chairman**. Senator Gore.

Senator **Gore**. Mr. Chairman, I don't have too many questions. I would like to compliment the Secretary on the work that she and her staff have done on this issue. I am most impressed with the enormous amount of work done and, the command of the subject matter. I am reserving judgment on this matter until I have had more opportunities to look into the objections that some have raised.

But I want you to know, because of the diligence and work you have put in, that I am inclined to support the outcome that you are recommending to the Senate. I have some concerns still about the treatment of the employees during the transition. I have some concerns about the charges of an anticompetitive result coming from this sale, even with the divestiture.

And I would simply give you an open-ended opportunity to reassure me on those two points. And please feel free to go ahead.

Secretary **Dole**. Thank you so much. I look forward to talking with you further about those points.

As far as the employees, we have enjoyed a very fine working relationship with rail labor throughout this entire process. Rail labor came in with a proposal—they were the first in July 1983. And when it became obvious that it was insufficient in terms of the financial backing, there were discussions as to other parties that they might join with. There was the opportunity to work together in trying to discuss all aspects of this, and that relationship has continued, both with Mr. Harden, the past president of RLEA, and Mr. Ole' Berge who is the current president, and individual presidents of the unions who belong to RLEA.

As far as the Norfolk Southern bid and how it would affect the employees, first of all, the discussions are ongoing. As a matter of fact, they will be meeting again tomorrow. And I am hopeful that very soon there will be an agreement between rail labor and Norfolk Southern. Norfolk Southern has offered $375 million or the equivalent in Norfolk Southern stock and warrants to the employees.

They have also, of course, early on indicated they would bring them back to full scale and retroactively to July 1, 1984. In addition, if there were at any point layoffs, they would receive 6 years' full salary. That is New York dock labor protection.

So I, as I say, am hopeful that as these discussions go forward, there indeed there will soon be an agreement with labor, and I am also convinced that there is a strong body of support within the labor unions for the Norfolk Southern deal.

Senator **Gore**. And you believe that the divestitures recommended by the Justice Department will prevent any anticompetitive result?

Secretary **Dole**. Yes. What the Justice Department did in its very thorough and exhaustive review of this was to look at every possible point, every market, taking commodity location pairs, and looking at, within the Norfolk Southern/Conrail service area, both the points of origin for goods and the points they are received.

Now, that also meant that in many instances, they were looking outside the Norfolk Southern/Conrail service area to points of origin that were not within that actual area. So it was a very broad market review, looking at all markets very thoroughly with the goal of ensuring that there would be no diminishing of competition, either on a qualitative or a quantitative basis.

In other words, if there are three railroads now, there have got to be three railroads after this merger. If there are two now, there would have to be two after. And not just competitors, but effective competitors.

So it was both from the standpoint of ensuring that the combining of operating and marketing strategies did not produce pricing leverage, but also ensuring that the number of effective competitors is not diminished. And it was a very thorough review and a very broad one, as I say, of every potential point and market in every county.

And in going through that review and looking at the way that they did their review and the screens that were used, I am certainly convinced it was a very thorough job. And, overall, I think that there will be efficiencies in that there will be long haul or single line carriage of goods in a number of instances that indeed will reduce the rates and provide carriage of goods in a shorter period of time.

Let me just give an example. Just use the State of Pennsylvania for a moment. With goods coming up from the South on Norfolk Southern's lines, chemicals, paper, and so on, there is, of course, the Potomac yards here, that often there is a delay there and a switching, and you are going to have single line now right into Pennsylvania, which will indeed cut down on the time and also provide for lower rates on the carriage of goods.

That is true in a number of instances. And also while I am talking about Pennsylvania, let me just mention that the impact of the smaller railroads, the Guilford in the East and the P&LE in the West, by picking up the vested lines' trackage rights and so on, that is going to have, I think, a positive effect for the State of Pennsylvania.

But overall, it does produce efficiencies as well.

Senator **Gore**. Well, I appreciate your response, and as I said before, Mr. Chairman, I continue to have some reservations, but it is nice to be able to talk about a set of options that are not all uniformly bleak and dismal, because the argument really is over whether or not we can get a better arrangement than the one you have come up with, and I just wish we had a range of choices like this all the time.

And again, I think the reason is the hard work that you and your staff have done, and I personally appreciate it. I think you have done an excellent job.

Secretary **Dole**. Thank you so much.

The **Chairman**. Senator Ford.

Senator **Ford**. Thank you, Mr. Chairman. I looked long and hard and found a mile of Conrail in my State.

I want you to know, Madam Secretary, that I represent all three rail entities that are here today, instead of two.

I think our biggest problem and that of those who are opposed is a worry about jobs facilities. They worry about the long-term—if you enter into a merger, what will that do ultimately?

So, Madam Secretary, let me ask you this question. If this merger is approved, do you see any problems as to closing of facilities or employees being fired, because I am getting that threat in my State, and my union members and employees are receiving letters saying that if this goes through, they will be fired or lose their jobs.

Now, let's get on the record what your opinion is, to ensure that we can attain a balance.

Secretary **Dole**. Senator Ford, I feel that this particular plan is very positive for the employees. And let me assure you, as I was saying earlier, we have worked very well with Rail Labor all the way through this process, and I have had the concerns of the employees very much on my mind, because they have made contributions to the turnaround of Conrail, they have given wage concessions, increased productvity, and indeed with the sacrifices that they have made and the spirit in which they have done it, I want to see this as a positive move for the employees, and I think it is time that they know what their future is and that we get this resolved and clear up the uncertainties for the employees.

And I feel that the Norfolk Southern choice is the best possible choice for the employees, because what they need is the knowledge that there is going to be a strong, viable, financially healthy railroad from now on, forever. And that is what this particular plan will insure.

From the standpoint of the employees, I would be looking at it as the fact that here is a railroad that would be purchasing Conrail that has the best operation and maintenance standards in the industry, a profitable railroad that obviously has excellent business management expertise in the area, committed to running a railroad.

There is no question about what is going to happen on down the line. And they have indicated that Conrail is going to be a full member of their family, equal member with the Norfolk & Western and the Southern, equal subsidiary; that indeed, they will be integrated into a very, very strong system.

And that is what is important for the future of the employees.

Senator **Ford**. I understand what you are saying, but you are referring basically to Conrail employees. The threat is to those who oppose the merger; they are saying that their facilities will be closed, their people will be fired. And if this is allowed to go through, they will be ruined.

So you think this issue is just Conrail employees, but there is a lot more that goes behind the tombstones down there for those of us who live with it every day.

Secretary DOLE. I think the statements I made earlier—perhaps you weren't here at that point, but let me just go back over that in terms of the fact that CSX has indicated—and you know, I've mentioned that I have had an opportunity to visit with Hayes Watkins several times. They are good friends, and they have indicated, though, that this merger would mean that they would have shut down the B&O and about 6,000 people would be out of jobs.

Senator FORD. It's up to 10 now.

Secretary DOLE. When you have 96.7 million tons of freight on that line last year, they will not, in any way, shape, or form that I can see pass ICC standards for abandoning those lines. That just isn't going to happen in my view.

Senator FORD. We get mail on this issue every day.

Secretary DOLE. And I think there is some confusion out there that ought to be clarified and indeed if they ever decided they wanted to do that, we can tell you there have already been offers, four expressions of strong interest in picking up everything that they want to divest, and those employees don't have to worry. They will have a job.

Senator FORD. Let me ask you—you said earlier that Justice, I believe, did a commodity comparison. Was it Justice?

Secretary DOLE. Commodity location pairs is the way they went about it. The Justice Department; that's right.

Senator FORD. What did they find as it related to coal, because both of these lines in my state are basically major coal haulers, or will be.

Secretary DOLE. I can talk about some specific areas with coal, but I think that in terms of the overall picture and how it affects your State—

Senator FORD. You can replace your husband anytime you want to. I prefer to hear you talk over him.

Secretary DOLE. OK. Well, I think basically Paul McGrath is going to have to give you the specifics on that.

Senator FORD. If you want to give it to me in writing so I can have it——

Mr. RILEY. We would be glad to, Senator. Bear in mind, there are no common points between Conrail and Norfolk Southern in your State. As you indicated yourself in the early testimony, there is no diversion in that area. What this merger creates is two strong coal competitors, and that can only benefit the coal miners. Better competition means lower price.

And, frankly, Senator, speaking as a spokesman for the industry, as I try to be, I think it is unfortunate that any company would hold its own employees hostage as a threat to oppose another merger. No one did that during the CSX merger.

(The following information was subsequently received for the record:)

The Justice Department's study of coal originations in Kentucky for purposes of the proposed Conrail sale to Norfolk Southern led to the conclusion that the 50/50 standard was not violated. Consequently, the Justice Department excluded coal flows from Kentucky from its list of problem markets.

The Southern's coal traffic moving north-south in Kentucky is negligible. Justice Department representatives have invformed us that they interviewed a large number of utilities using coal from Kentucky and other States in the joint system. The large majority of the utilities contacted indicated they saw no problem with the NS acquisition of Conrail.

Senator FORD. You will then give me a statement. Make it timely if you can, because it is beginning to move in a direction for which I think we need to have those kinds of answers.

The CHAIRMAN. Madam Secretary, I just have one further question. The Justice Department in its letter says with respect to divestiture, the first condition that divestiture must satisfy is that the acquirer must demonstrate to the satisfaction of the Attorney General that it possesses the managerial, operational, and financial capability necessary to compete effectively and to remain a viable entity.

Are you confident that the railroads receiving the fruits of divestiture from Conrail or Norfolk Southern are going to be able to meet this standard? Is there any possibility that you see that either the Government or Conrail itself is going to end up owning the same track again, or that it will be somehow abandoned?

Secretary DOLE. Well, I feel that they will pass Justice muster on that. As you say, Justice does, of course, retain jurisdiction until they have determined that there is a fair market value and that all aspects of it are——

The CHAIRMAN. But I am talking about the viability of the receiving railroads.

Secretary DOLE. For example, the Guilford. Let me just speak to the Guilford for a moment. Of course, Guilford was one of the bidders for Conrail. The Guilford has pointed to the effective competition with Conrail through their purchase last year of the D&H.

Also, they have, they feel, a very strong base in that they have gone in already to New York and to Philadelphia, to Boston, to Buffalo, and indeed with the opportunity now to move west and to have new gateways and new opportunities, I don't think there is a question on that.

But obviously, Justice does have the final say.

The CHAIRMAN. Would there be anything to prevent the receiving railroad to turn around a year from now and resell it to Norfolk Southern?

Mr. RILEY. Senator, in that type of transaction, they would not have the broad exemption from the ICC that is part of NERSA. They would have to go back into the ICC, again face the Justice Department, face ICC inspection, and make a finding of public convenience and necessity, which I suspect would be very difficult.

The CHAIRMAN. Any further questions? Senator Riegle?

Senator RIEGLE. Yes, I do, Mr. Chairman. I just want to make sure we are clearly on the record, Madam Secretary, as to where rail labor is at this point.

Are they supporting the proposal? Opposing the proposal? What is their current position?

Secretary DOLE. Labor is in the process of discussing, negotiating with Norfolk Southern, and a deal has not been reached. But those discussions will continue tomorrow, and I am hopeful that they will soon reach agreement.

Senator RIEGLE. I am under the impression that there was a time several weeks ago when it looked as if rail labor was supporting the proposal that you have put forward. And then I read news accounts to the effect that they had changed their minds and had backed away from that.

Now, is that the current status? I want you to elaborate on it out here more fully.

Secretary DOLE. I think what you are referring to is a vote of rail labor for the Alleghany proposal which was one of the three final bids. I have always said that it is important to me to receive labor's input. And as I say, we have had really a continuing dialog, almost daily contact for many, many months.

The vote for Alleghany, I did take into consideration as I was making my determination. Obviously, I have to do overall what I feel is going to be in the public interest, in the interest of the employees, the shippers, the entire Nation in terms of this railroad forever being a strong, financially healthy railroad, preserving the shipping patterns.

I made that decision and I am very confident that I made the right decision on this. I expect that these negotiations that are taking place between Norfolk Southern and labor will produce an agreement, and I do feel that there is a strong body of support for the Norfolk Southern deal within the labor organization.

So it is just in process at this point. And as I say, I am confident that they will reach an agreement.

Senator RIEGLE. Well, let me just——

Secretary DOLE. What Norfolk Southern has proposed to labor is a good offer in terms of the elements that we are aware of at this point.

Senator RIEGLE. That is as you see it, and I understand that, and I am not challenging that. I am trying to establish how labor sees it at this point, as you understand it. Am I not correct in thinking that they backed away from being more positive about the proposal several weeks ago than they have been more recently?

I have had the impression that the major labor organizations have become more skeptical about it and that they are not supporting the proposal at the present time.

Secretary DOLE. I don't think that can be said. It's really ongoing. And I think what you have in mind there is the fact that there was this vote on Alleghany. But the best way to characterize it is that they are showing good faith interest in my choice of Norfolk Southern by being willing to sit down at the table with Norfolk Southern and go forward to try to develop an agreement.

And that was going on last week. They intend to continue again tomorrow. So I wouldn't want to say any more than that at this point in trying to characterize it, except that I am very hopeful that they will reach agreement soon, and I think the vote for Alleghany certainly should not be read to mean that they were against the others.

Senator RIEGLE. So you have no sense, and you would not reflect to the committee that you have any sense that any of the rail labor organizations are opposed to what you are trying to do or that they find the differences irreconcilable, or seeming so; and in fact, they are quite positive and they are moving along in the same direction as you are? Is that how you would characterize it?

Secretary DOLE. Well, I think the way I would characterize it really is just basically what I have said; that I do feel there is a body of support for Norfolk Southern. They are in negotiations now, which shows a good faith effort to sit down and work something out.

There is one union, BRAC, and Dick Kilroy, who said that he as president is against the deal, that he would favor public offering. So that one is firmly on record saying public offering rather than the Norfolk Southern negotiated bid. But other than that one union, I would be hopeful that indeed they will soon indicate support and sign an agreement.

Senator RIEGLE. Thank you.

The CHAIRMAN. Senator Hollings.

Senator HOLLINGS. Thank you very much, Mr. Chairman.

Madam Secretary, concern has been raised that the Justice Department report inappropriately narrowed its focus to certain movements under certain circumstances. For example, they didn't consider traffic diversions from other systems, and their impact on competition.

Were the criteria arbitrarily established, and were there certain anticompetitive problems ignored?

Secretary DOLE. Well, I certainly would not characterize it that way. Of course, Paul McGrath will be with you later in the day to discuss specifically, exactly how the standards were set. But I know that certainly the Justice Department utilized the standard that they have used in the past in terms of the 50/10 standard, which I can go into, or perhaps it would be better if Mr. McGrath did, and the screens that were used.

But let me just say that, first of all, you have a team at the Justice Department in the Transportation Division that is highly expert in this area. They utilized the guidelines, Justice guidelines that were established, obviously, before this deal was reviewed. They have been active in rail mergers in the late 1970's, in the 1980's, in all of the major cases. They are independent experts in this area, who I think have done a very thorough and painstaking job going point by point, county by county, market by market, and very thoroughly analyzing competition to ensure that competition is not diminished, either qualitatively or quantitatively; that there is no opportunity for pricing leverage through combining operating and marketing strategies, and also that the number of effective competitors is not diminished.

Now, they did find some significant anticompetitive points and they indicated that unless certain steps were taken, they could not give clearance to this merger. So they will have final signoff, and indeed those divestitures, those agreements for trackage rights, for reciprocal switching, for opening of gateways, Buffalo, Toledo, East St. Louis, Chicago, that all has to be done or there will be no sale to Norfolk Southern.

And indeed, I think the fact that there has been an agreement reached in principle with the P&LE and the Guilford indicates that that is the first step in completing the Justice's process. But I think they did a very thorough job and they utilized standards, of course, Clayton Act and the standards, of course, very similar to the Interstate Commerce Act.

Senator HOLLINGS. Well, you've practically answered what I was going to ask—is this a merger that otherwise would be inappropriate, that would not be confirmed because of anticompetitive reasons or market price reasons or otherwise?

Secretary DOLE. No.

Senator HOLLINGS. Madam Secretary, what procedure did you follow in determining the value of Conrail? In other words, was the procedure similar to that used in evaluating railroads or other businesses for the purposes of a sale? What procedure was used?

Secretary DOLE. In terms of looking at each of the offers and——

Senator HOLLINGS. For Conrail itself, in determining its value and then assessing the offers.

Secretary DOLE. Of course, this is where Goldman, Sachs provided the expertise in terms of analyzing Conrail and its operations, and then comparing each of the financial deals, and what Conrail would look like standing alone, and Conrail merged with each of these entities that were final bidders.

But the way I looked at each deal basically was, again, from the standpoint of what does this do to the financial strength of Conrail? In other words, what kind of preferred stock is going to be—what is the package, the component of preferred stock, and what kind of dividends would have to be paid?

What about common stock and dividends? What about cash being taken out of the company in order to pay the Government? What kinds of loans and leveraging against the assets of Conrail are involved in this deal? You know, we ruled out a number of bids early on, because when you got behind the figures, they were just leveraged buyouts. They simply did not have the financial backing to carry it through.

So basically, we went through a number of steps, but of course Goldman, Sachs was giving me their advice in analyzing each of these very thoroughly.

Senator HOLLINGS. Can Mr. Brody elaborate on that, please? I just want to know the procedure used by Goldman, Sachs in evaluating Conrail itself.

Mr. BRODY. I think the simplest answer to that is the procedures that we used in coming up with a value for Conrail in the marketplace are quite similar to the procedures that we use in selling any other company that we have for sale. I mean there is nothing that we did to cut back.

The one difference here is, as opposed to most sellers, the seller here has quite an interest in the financial strength of the ongoing operation and has an interest in a number of other public policy areas. And except for how those public policy considerations affected the process, the process was just the same as if we were selling any other company in determining the value of that company.

Senator HOLLINGS. And finally, the letter that you wrote on January 24—if we could have that letter, the letter with respect to the public offering in which you said that you did not think it was a good offering or a good procedure. Can we have that, plus the update, for the record? [1]

Secretary **Dole**. Yes.

Senator Hollings, let me just make one final point on the public offering. I think one way to look at it, if you are the person who's got to make the decision to recommend to the Congress a plan that is truly going to be in the public interest—that is my mandate. It is not anything other than determining what is going to be best for the employees, what is going to be best for the shippers, and overall best for the public generally.

I have a bird in the hand on the one hand. I have got $1.2 billion in cash, cash on the barrelhead, paid to the Government the day of closing. Any cash over $800 million in that company on the day of closing goes to the Government. I have the surrender of net operating losses and investment tax credits that equals about $2.4 billion. That is real value to the treasury.

And I have a lot of tough covenants designed to ensure the financial strength of this railroad, and that is what is important for the employees and for everyone, for the shippers, that that railroad be strong and healthy from now on forever. I have got that.

Now, on the other hand, I have something that is an opinion: We are of the opinion that we can do this public offering.

What would you do if you were in my shoes and you had this bird in the hand, this strong deal, and you have got an opinion over here, and an opinion that involves uncharted waters, basically, in that there have only been 10 public offerings in this country over $300 million? There has only been one initial public offering of an industrial company over $300 million. It would be the largest component of preferred stock ever offered in this country. $300 million cash coming out of the company.

You know, what do you do about the covenants in a public offering? Certainly you would expect—and Ken can speak to this better than I, but I would certainly expect it is going to depress the value if you put those covenants out there in a public stock offering. And I think they are essential to this deal if you want a strong Conrail in the future.

So I just want to make that final comment on public offering, that if you are the person who has to determine what is in the public interest I would find it very hard to give up a strong deal with a known entity.

I had the chance to sit down and eyeball these people across the table many rounds of negotiations. I knew who I was dealing with. I do not know in a public offering who I am dealing with.

But certainly, when I can sit down with Bill Marriott and with Fred Kirby and with Bob Claytor and their management teams and I can know what kind of—do they have commitment to running a railroad? Are they people of integrity? Have they got good management skills? What kind of—how do they run their railroad? Do they have the best operating procedures in the business and maintenance standards? Yes; they do in Norfolk Southern's case.

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[1] The material was received and is in the Committee files.

And if you want a strong railroad, you do not want lines abandoned and service diminishing, you do not want downgrading of lines, that means it has to be financially healthy. Otherwise they begin to downgrade the lines in certain areas and it becomes a self-fulfilling prophecy to eventually abandon those lines.

That is the kind of thing we were watching for and that is why it is so important that the first criteria for this sale be the financial strength of the railroad, not squeezing every last dollar you can get. And we want to maximize the return to the Government, but that is only after we ensure the financial strength of the railroad.

And those covenants cost me money. I could have gotten more money without the covenants. But I want the covenants, and I do not know how you get them in a public offering, certainly without a decrease in the value.

Senator HOLLINGS. Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Exon, do you have any questions?

Senator EXON. I will pass for the present time, Mr. Chairman.

Senator FORD. Mr. Chairman, I would like to have just one question if I may.

The CHAIRMAN. Sure.

Senator FORD. Madam Secretary, one other item I would like to get cleared up, to eliminate some of the brush fires that are being developed. Circulating in eastern Kentucky is that the coal from the eastern Kentucky coalfields will not move north because there will not be any joint rates with Conrail.

Is this really a possibility?

Mr. RILEY. Senator, the answer to that is there is no more motivation for NS-Conrail to cut off profitable coal movements than there is for Conrail standing alone to cut off profitable coal movements. The markets are north, the coal is in the south.

I think we have to assume, and I think experience dictates that the assumption is correct, that both Conrail and the successor Conrail-Norfolk Southern will seek those profits, as they traditionally have. So the answer to that is of course not, Senator.

Senator FORD. Thank you very much. You are on the record.

Secretary DOLE. I would like to add on the record, too, that as far as the Raceland facility, there is certainly no indication that it would be impacted, and that has been another of the rumors that has been floating around.

And Senator Rockefeller, I just mention while we are on the subject of coal and the movement of coal, West Virginia coal now travels by Conrail via Columbus, OH. This merger would mean that it would travel by Hagerstown, MD, which is a more direct route to the Port of Philadelphia. And this indeed is expected to bring down rates to provide more efficiencies, and that is the kind of thing that I think we can look to that will provide some positive impacts, rather than just holding the line on competition.

Senator FORD. Mr. Chairman, could I compliment the Secretary on her knowledge of geography. And if she knows where Raceland, KY, is, she knows where everything is.

Secretary DOLE. Well, I understand there have been a few rumors about Raceland. Let us put that one to rest.

The CHAIRMAN. Senator Long.

Senator LONG. Ms. Dole, just to get a better understanding of where we are at the moment, it is my understanding according to what you have told us here that the number of employees of Conrail has been reduced from 100,000 to 37,000, is that correct?

Secretary DOLE. Yes, from 1976 when it was first formed.

Senator LONG. And I believe you also said that under the law, or whatever, they are entitled to draw 6 years terminal pay?

Secretary DOLE. New York Dock is the standard that Norfolk Southern would apply. In other words, they would offer the employees the New York Dock standard, which would be full salary, it could be full salary for 6 years.

Senator LONG. What I am thinking is that under the existing arrangement I assume that there is some termination. The termination pay that someone gets from the railroad, is that 6 years as it stands now?

Secretary DOLE. You mean the way Conrail operates now?

Senator LONG. The way it stands right now.

Secretary DOLE. Right now, section 701 would provide for $20,000. In other words, that is a much richer deal than the current labor protection that the Government pays, which is $20,000 per employee. Section 701 of NERSA.

Senator LONG. I am just trying to get this straight, because it seems to me that Conrail will be a more viable corporation when it has succeeded in paying off the cost of terminating those employees. And I would think that the cost of terminating employees is still part of, a substantial part of the cost of that corporation.

Is it or not? I would just like to know.

Secretary DOLE. The Government pays labor protection now. We have already paid $77 million in workforce reduction labor protection alone. If the railroad would stay in the Federal Government, you all will have to look at what we do next, because it is down to about $42 million in that pot of money for labor protection now.

Senator LONG. I am just trying to get this straight in my mind, because not knowing any better, I would have assumed that the corporation would have to sustain the cost of terminating these employees and that that would reduce the profits of the corporation; and further, that at such time as the cost has been paid out, then at that point the railroad ought to look better from a profit and loss point of view. I am just trying to get this straight.

Do I understand from you that the Government has been sustaining the burden of laying off these employees?

Secretary DOLE. Yes, sir, that is right.

Senator LONG. And that has not been reflecting itself in the profit and loss statement of the railroad?

Secretary DOLE. That is right. You see, the railroad has been profitable for 5 years now. But there would be no profitability the first 2 years if they had been paying their labor protection, if they had been paying their State taxes, and if the employees had not agreed to a 12-percent wage concession. There would have been no profits the first 2 years.

The third year it would have been only about $80 million. And last year, rather than being $500 million profits, it would have been $250 million.

So going back to the private sector it is not going to have as strong a profit picture as it does with all of us contributing.

Senator LONG. Now, would you explain to me this gateway concept that you have been mentioning? I am sure that if I were in the railroad business I would understand exactly what you are talking about. I have never been in the railroad business.

Would you mind explaining it? You mentioned the Buffalo gateway and certain other gateways. Would you explain to me how that works?

Secretary DOLE. Basically, let me give an example, Cleveland to Buffalo line, and a little past history on this. Prior to the time that Conrail was formed, Norfolk Southern, they traveled the Cleveland to Buffalo line there and they had friendly connections with smaller railroads outside of Buffalo.

Now, when Conrail was formed that gateway was closed. In other words, that was cut off, being able to connect with those friendly railroads. And this meant basically that what has happened to that line is gradually traffic has been diverted over to the Conrail line with a straight-line connection, and the Norfolk Southern line has reached the point that there is only one train a day traveling across that line.

Now, they would eventually have had to abandon that line. But because of the Justice Department's requirements, they will indeed be selling that line now and the gateway at Buffalo will be opened, so that the Guilford Railroad can go through Buffalo, to purchase this line, and right on into Cleveland and on across.

So it is basically—and Guilford not only picks up any traffic that is on that line, but also traffic that Norfolk Southern would have had but for its competition with Conrail, which basically closed them off at Buffalo. So it is a matter of giving them access.

And the gateways that are most important in this merger will be Buffalo, Pittsburgh, St. Louis, and Chicago. They will be opened up to the smaller railroads so that they can go through and pick up lines and move out. In fact, with the P&LE it gives them an opportunity to break out of a situation where they have been isolated basically by Conrail competition. They can break out of that region now.

Senator LONG. Did you mention Cleveland as being one of the gateway points?

Secretary DOLE. No. The gateways basically are Buffalo, Pittsburgh, St. Louis, and Chicago.

Senator LONG. Thank you very much.

Senator HOLLINGS. And the job loss, Mr. Chairman, if you do not mind, is by attrition, as I understand, Madam Secretary, and not firings?

Secretary DOLE. That is right. We do not expect layoffs, but by attrition. And it would be less than half of the combined Norfolk Southern-Conrail normal yearly attrition that occurs now. If you were to combine the two, it would be less than half of the normal attrition.

The CHAIRMAN. Senator Exon.

Senator EXON. Madam Secretary, I listened with interest to the response that was made to the questions from the coal States regarding whether or not, if the recommendation that you make is followed, it would make any significant difference with regard to shipments of coal from Kentucky, say to the northern points.

And if I understood, the response was no, you anticipate no difficulty whatsoever with that, because whatever the carrier is, the same basic situation would be in place. In other words, somebody has got to move that coal, and it would move just as efficiently and you are assuming at the same rate as under the present system.

Secretary DOLE. I believe that was Mr. Riley's answer, and he will elaborate. But I would also like to provide more information for you in writing on this coal situation.

Senator EXON. Since he is about to answer, let me follow up to the question I am really aiming at. Would that response also apply on shipments from Nebraska to those northern places?

And since Nebraska is a noncoal shipper, my key question is what, if any, effect would the proposal have on wheat, corn, and other commodities that go into that section of the country? Would the same general answer that you gave on coal apply, in your opinion?

Mr. RILEY. It is different, Senator. It is different because the traffic flow is different. Conrail is far enough away from your State and my State in Minnesota that actually the merger, while I would like to say it will do great things for both of our States, will have very little impact on either State.

East-west movements in the Conrail system will remain essentially as they are today, and that is assured by the entry of at least one new carrier into the Chicago gateway. So the Western shippers have as many choices after the merger as they had before it, with essentially the same terminating points.

To the extent that your State or my State receives anything that moves north-south within the combined system, it will ship more cheaply, because presently anyone shipping north-south has to pay a joint rate on both Conrail and its connecting carrier. They lose a night in the yard and they pay switching fees. That will no longer be the case.

So on east-west traffic, which most of our traffic is, it will be the same. There are special economics in the coal districts that dictate the other answer. In your State and in mine, I suspect we will see no debit, no benefit, unless we happen to pick up a north-south movement somewhere.

Senator EXON. So from the standpoint of Nebraska and the movement of grain in particular, you are saying that your assumption is that it would be neutral as far as any change is concerned under the present arrangement?

Mr. RILEY. That is correct. Most of our grain moves west. To the extent it moves east, it moves to lake points that are not affected by this. Some goes into Chicago. Chicago has as many competitors after the merger as it did before. Some goes south to the gulf. The gulf is unaffected.

Senator EXON. Would the same thing be true, then, of commercial movement of freight from the Northeast to Nebraska?

Mr. RILEY. To the extent it is moving east-west—and I think most of it does, Senator—there is not going to be a change, because there are two key gateways. Chicago is the key gateway for movements to our area, and in Chicago you shrink one carrier when you merge NS and when you merge Conrail, but you gain a carrier when you make the Guilford system essentially a half-transcontinental railroad.

In addition, the way the Belt Carrier works in Chicago, that ensures the same number of terminating points for our shippers.

Senator EXON. Then to make it clear once again, the testimony that is on record here this morning is that in the opinion of the Department of Transportation, if your recommendation becomes law you can see no change in either rates or you can see no change in service on either east-west or west-east movements as far as Nebraska is concerned, is that right?

Mr. RILEY. That is correct, Senator. Let me make very plain what I mean when I say no change. I am not telling you that 50 years from now every rate is going to be exactly the same as it is today.

Senator EXON. Will it be the same in 1 year?

Mr. RILEY. What I am saying, Senator, is that it will be the same with the merger as it would have been without it, either upward or downward, because none of the competitive factors change. It is a no impact.

Senator EXON. Then the answer is that if this becomes law you can envision no changes now on either east-west or west-east shipments into the State of Nebraska that otherwise would not have occurred?

Mr. RILEY. That is correct, Senator. I would like to cite an advantage, but I cannot find it.

Senator EXON. Thank you. I had great difficulty in getting down to the bottom line, but we finally made it.

The CHAIRMAN. Thank you.

If there are no more questions, Madam Secretary, Mr. Brody, Mr. Riley, thank you very much.

Secretary DOLE. Thank you, Mr. Chairman.

The CHAIRMAN. Madam Secretary, congratulations on doing an amazing job as a witness and on your preparation in putting this whole arrangement together. I think that I speak for the committee. Both Senator Hollings and I have been discussing your testimony and you did just a really remarkable job.

Secretary DOLE. Well, thank you very much, Senator. And we look forward to working with each of the members of this committee. Obviously, this committee has tremendous expertise in this area, and I will welcome the chance now to work with you as we move forward on this.

Thank you so much.

The CHAIRMAN. Thank you, Madam Secretary.

(The following information was subsequently received for the record:)

QUESTIONS OF THE CHAIRMAN AND THE ANSWERS

Question. What are Conrail's current and future earnings and financial position?

Answer.

TABLE 3-3.—SOURCES AND USES OF CASH BASE CASE

[In millions of current dollars]

	1984	1985	1986	1987	1988	Period total
Sources:						
Income before nonoperating income	450	404	210	269	476	1,809
Nonoperating income	50	24	−3	−7	−17	47
Net income	500	428	207	262	459	1,856
Noncash items	195	214	247	254	265	1,175
Funds from operations	695	642	454	516	724	3,031
Property sales	95	75	40	30	30	270
Total sources	790	717	494	546	754	3,301
Uses:						
Capital programs:						
Track rehabilitation	285	294	205	231	332	1,347
A&I	113	135	115	122	152	637
Equipment	152	128	95	203	297	875
Total capital	550	557	415	556	781	2,859
Less financing	157	137	85	199	275	853
Capital—net	393	420	330	357	506	2,006
Equipment debt installments	128	130	112	119	132	621
Working capital changes	−44	42	35	40	45	118
Total uses	477	592	477	516	683	2,745
Change in cash	313	125	17	30	71	556
Cash on hand ($533 million as of Dec. 31, 1983)	846	971	988	1,018	1,089	[1]

[1] NA.

Source: United States Railway Association Outlook for Conrail, 1985–1988, April 1985.

INCOME STATEMENT (COMPANY ONLY) JANUARY 1985

[In millions of dollars]

	Actual	Budget	Prior year	Variance from	
				Budget	Prior year
Operating revenues: Freight	252	270	261	(18)	(9)
Operating expenses:					
Way and structures	48	43	44	(5)	(4)
Equipment	40	40	41		1
Transportation	118	124	117	6	(1)
General, administrative, and other	26	28	23	2	(3)
Equipment rents	24	26	25	2	1
Total operating expenses	256	261	250	5	(6)
Operating income	(4)	9	11	(13)	(15)
Nonoperating items	2	5	5	(3)	(3)
Net income (loss)	(2)	14	16	(16)	(18)

Variance better (worse).

INCOME STATEMENT (COMPANY ONLY) FEBRUARY 1985

[In millions of dollars]

	Preliminary	Budget	Prior year	Variance from	
				Budget	Prior year
Operating revenues: Freight	248	265	276	(17)	(28)
Operating expenses:					
Way and structures	41	41	44		3
Equipment	39	38	40	(1)	1
Transportation	111	118	116	7	5
General, administrative, and other	26	27	24	1	(2)
Equipment rents	23	22	24	(1)	1
Total operating expenses	240	246	248	6	8
Operating income	8	19	28	(11)	(20)
Nonoperating items	2	3		(1)	2
Net income	10	22	28	(12)	(18)

Variance better (worse).

INCOME STATEMENT (COMPANY ONLY) JANUARY THROUGH FEBRUARY 1985

[In millions of dollars]

	Preliminary	Budget	Prior year	Variance from	
				Budget	Prior year
Operating revenues: freight	499	534	537	(35)	(38)
Operating expenses:					
Way and structures	89	84	88	(5)	(1)
Equipment	79	78	81	(1)	2
Transportation	230	242	233	12	3
General, administrative and other	51	54	47	3	(4)
Equipment rents	46	48	49	2	3
Total operating expenses	495	506	498	11	3
Operating income	4	28	39	(24)	(35)
Nonoperating items	4	8	5	(4)	(1)
Net income	8	36	44	(28)	(36)

Variance better (worse).

QUESTIONS OF SENATOR KASTEN AND THE ANSWERS

Question. What impact will the sale of Conrail to Norfolk Southern have on rail competition in states in the Midwest like Wisconsin?

Answer. Shippers in the Midwest and Plains states will most likely see no change in the service they now receive when interconnecting with Conrail. The Conrail-Norfolk Southern consolidation plan provides for retention of routes from the Midwest gateways to the parts of the Atlantic region that are now served by Conrail.

Question. Has Conrail recovered sufficiently to operate indefinitely in the black without the support of Federal subsidies and tax breaks if Congress would approve a public offering?

Answer. Although projections several years into the future are tenuous at best, Conrail's projections for 1985-88 and FRA's projections for 1985-93 predict modest positive cash flows. We have concluded that, barring any substantial cash requirements for servicing acquisition debt or preferred and/or common stock, Conrail can be marginally self-sufficient as an entity in the short run.

We do not, however, believe it is likely that a public offering can be structured that will avoid having an adverse affect on Conrail's modest postive cash flow.

Goldman Sachs provided the following projection of Conrail's cash flow and need for borrowings:

CONRAIL: SELECTED STATISTICS ON THE PRIVATIZATION PLAN [1]

[In millions of dollars]

	1985	1986	1987	1988
Balance sheet information:				
Cash	$531	$500	$500	$500
Debt	862	896	1,068	1,270
Income statement information:				
Pre-tax income	438	216	259	446
Income taxes	(131)	(6)	(14)	(83)
Net income before preferred dividends	307	210	244	363
Preferred dividends	(72)	(72)	(72)	(72)
Net income available to common	235	138	172	291
cash flow information:				
Sources:				
Net income before dividends	307	210	244	363
Deferred taxes	131	6	14	83
Depreciation	214	247	254	265
Other	33	5	(10)	(15)
Cash flow	685	468	502	696
Uses of cash:				
Preferred dividends	72	72	72	72
Common dividends	54	54	54	54
Capital expenditures	557	408	548	772
Debt installments	123	112	119	132
Total uses	806	646	793	1,030
Net cash flow	(121)	(178)	(291)	(334)
Additional net borrowings	14	34	172	202
Cumulative increase in borrowings	14	48	220	422

[1] These figures are derived from conversations with Morgan Stanley and Conrail management, and from the Privatization Plan dated January 2, 1985, which may be subject to revisions.

Source: Letter to Secretary of Transportation Elizabeth H. Dole from Goldman, Sachs and Co., January 24, 1985.

Question. What assurances can you give me that a public sale offering will raise enough capital to finance more than just a leveraged buyout of Conrail?

Answer. That is just the point. I cannot give you such an assurance. A public offering has all of the financial risks associated with a leveraged buyout.

No public sale has been structured to date that does not leverage against the assets of the company or take cash directly out of the company. The most recently proposal, put forward by Conrail management, took

$300 million cash out of the company,

Anticipated selling $500 million in common stock, and

$600 million in preferred stock.

The cash burden of paying preferred stock dividends on an annual or even cumulative basis adds an additional $126 million burden on Conrail's profits.

In addition, no public sale can achieve the dual objective of maximizing return to government and protecting the public interest through public interest covenants.

Even without the protective covenants Norfolk Southern has agreed to, the current traffic decline being experienced by railroads in general, including Conrail, make it unlikely that a public offering would provide a greater return than NS has offered.

Without the additional earnings associated with the efficiencies achievable by a NS-Conrail combination, as well as the additional stability and strength of NS's balance sheet, Conrail's future would not be assured. Its financial prospects would be further weakened by a requirement for the payment of substantial preferred and common stock dividends. High dividend rates are likely to be required for issue of Conrail stock due to the risk of a Conrail investment.

The cumulative burden of preferred stock dividends produces the same financial impact as the requirement to service debt under a leveraged buyout.

QUESTIONS OF SENATOR TRIBLE AND THE ANSWERS

Question. Did the Transportation Department examine the issues raised in this letter and statement regarding RF&P's ability to continue to compete on the Potomac Yard—Richmond Route?

Answer. We performed only an analysis of the Potomac Yard gateway in Alexandria.

The Department of Justice performed a broader study of all traffic flowing into and out of regions served by Conrail and NS. This analysis was done independently from DOT and we must refer the question to the Department of Justice for response.

Question. What were the results of this (see Question #1) examination.

Answers. Our analysis of the Potomac Yard gateway showed CSX (including RF&P) as the major factor in all traffic moving through the yard and via the RF&P. The attached table shows the relative market shares of traffic flowing through Potomac Yard in both directions. In a larger sense, it was assumed there would be no change of relative market positions north of Philadelphia, as CSX does not now serve that area.

With respect to RF&Ps overall operations, the following points should be made:

Notwithstanding the fact that RF&P does operate as a separate and independent railroad company, it is dependent for a large part of its traffic on connections with CSX Corporation railroads and, by virtue of system mergers over the years, CSX controls a majority of its voting shares. Because of these relationships, RF&P is usually viewed for traffic and operating purposes as an affiliate of the CSX railroads—specifically, Chessie System north of Washington and Family Lines (Seaboard Coast Line) railroads south of Richmond.

RF&P forwards very substantial quantities of traffic to Conrail at Potomac Yard in Alexandria and substantial quantities of traffic are also forwarded to CSX's Chessie System, which parallels Conrail north to Philadelphia. Conrail does not produce equivalent reciprocal traffic and Conrail would have to think hard about losing its share of both northbound and southbound traffic by failing to cooperate with RF&P. While Southern Railway (a unit of Norfolk Southern) could possibly divert traffic from its line from the southwest to Alexandria over to its Shenandoah Valley line through Hagerstown, much of this traffic is time sensitive and would be difficult to divert.

There is another development which could benefit the RF&P. Norfolk Southern looks forward to developing a sizeable new volume of business by offering lower rates on traffic now in the hands of truckers. To the extent that this traffic is both time and cost sensitive, it must flow up the seaboard via the most direct available route—the RF&P.

1982 MARKET SHARE AT THE POTOMAC YARD GATEWAY

[Carloads]

Northbound	Percent	Southbound	Percent
NS system forwarding to northern carriers	33	Northern carriers forwarding to NS System	22
CSX railroads forwarding to northern carriers	[1] 67	Northern carriers forwarding to CSX railroads	78

[1] The bulk of this traffic is handled to or from connections at Richmond and Washington via RF&P.

Question. What protections are available to RF&P to ensure that it can continue to compete?

Answer. The RF&P has asked for specific protections which are mirrored by specific provisions of the Memorandum of Intent between DOT and Norfolk Southern. In addition, business arrangements have been tendered by NS to CSX which would benefit RF&P's traffic flows. Both these subjects are addressed in the answer to question number 5.

Question. Within the context of the Conrail legislation would you suggest amendments which would ensure that the RF&P could continue to compete in its present markets?

Answer. The legislation to enable the sale of Conrail should not be used as a vehicle to produce specific business arrangements between and among carriers. These are typically too particularized and complicated to be addressed by legislative prescriptions.

Question. Response to the conditions requested in the RF&P letter.

Answer. "Rate and route protection on traffic through the Potomac Yard gateway" . . . .

Section 12(a)(viii) of the Memorandum of Intent imposes the requirement that Conrail (in Norfolk Southern's hands) shall maintain or re-establish with small eastern carriers of under $300 million annual operating revenues reasonably direct and cost competitive routes of major importance. It is clear that RF&P will be a beneficiary of these provisions to the extent they apply to its traffic moving over Conrail or which could be moved over Conrail.

"RF&P should be given the opportunity to acquire trackage rights between Potomac Yard and the New York area."

It should be noted at this juncture that the bulk of RF&P traffic moving between the South and New York derives from CSX connections and the railroads operate in close affiliation. Norfolk Southern has already offered CSX Corporation access to New York in return for equivalent access to points in Florida which CSX now serves exclusively.

Still broader protection will be afforded RF&P and its shippers as a consequence of an accord reached between the Association of American Railroads (on behalf of railroads) and the National Industrial Traffic League. This accord, which has been presented to the ICC for ratification, will afford small carrier's opportunities to protest the actions of large carriers in closing of routes and discriminating in rate setting in order to foreclose or divert jointly handled traffic and when upheld to receive redress in a reasonable time frame.

QUESTIONS OF SENATOR RIEGLE AND THE ANSWERS

Question. In order to complete the divestiture of lines, it will be necessary to merge the Conrail or Norfolk Southern employees into the successor's labor force. How exactly will this be accomplished while preserving all seniority rights and pension benefits?

Answer. Fortunately, most of the lines to be divested have been part of Norfolk Southern, so that detailed information about classes of employees and seniority districts is available to Norfolk Southern. Conrail has, we understand, provided Norfolk Southern generalized information so that a working knowledge about employment on those Conrail lines to be divested is also at hand. Because of the broad scope and system configuration of the divestitures, seniority districts can generally be dealt with as complete entities, again simplifying the procedure. Norfolk Southern has estimated that 2,530 positions will be affected by the entire acquisition with about 700 of these, the great bulk of them Norfolk Southern employees, affected by the divestitures and transferred along seniority district lines to the acquiring carriers. Norfolk Southern and the acquiring carriers have agreed that seniority rights and pension benefits shall be maintained as a fundamental proposition. In addition, so-called New York Dock termination benefits (six years' salary plus inflation increments) will be paid to all employees who suffer a loss of employment as a result of the acquisition.

Question. What steps have you taken to ensure that Grand Trunk Railroad is not put at a competitive disadvantage as a result of the sale to Norfolk Southern and the divestiture to Guilford and P&LE? This is especially important in light of the fact that Grand Trunk will not obtain any of the divested routes and will not acquire any additional gateways.

Answers. We have been mindful of Grand Trunk's position an we are equally resolved to do everything possible to promote a community of interest among the regional carriers in the east so that each of them will derive competitive benefits from the system of lines to be divested. To that end, we have hosted a number of meetings intended to make Grand Trunk aware of Guilford and P&LE's plans so that should those two carriers acquire the lines, the ground work would be laid for joint traffic arrangements. We understand that Grand Trunk and Guilford operating department personnel will meet to discuss in detail how Guilford intends to operate from Toledo to Chicago and Toledo to St. Louis and to explore cooperative arrangements.

Question. It is contended that the lines that NS will sell to Guilford and P&LE will require fairly major rehabilitation to make them competitive with existing Conrail tracks. Please give me your best estimate of the condition of these lines. Is this estimate based on F.R.A. engineering surveys?

Answer. We have heard estimates of more than $100 million being used as the cost of rehabilitating these lines. We believe these estimates may be based on bringing the lines to the maximum standards necessary to operate high speed passenger trains—these are not the track conditions necessary to operate freight service safely and efficiently. With the exception of portions of the line to St. Louis, all of these lines have been maintained for mainline freight operations by Norfolk Southern and/or or mainline passenger operations on the segment from Fort Wayne to Chicago. This track is subject to FRA safety regulations and most is indicated for so-called Class 4 suitable for 70 mph passenger and 50 mph freight operation. Again, most of this track is signaled for such operation. In addition, I would note that both P&LE and Guilford have spent large amounts of time and money surveying these lines and selecting those which best meet their needs. Their surveys have led them to believe that rehabilitation needs, if any, are well within their capacity, including those requirements pertaining to Guilford's purchase of the Toledo-St. Louis lines.

Question. Have you developed any proposals to divide the proceeds of the sale among the states that are now served by Conrail. These have all made significant contributions to the success of the railroad, in the form of tax abeyance, state-funded rehabilitation projects, etc. Do you agree that some sort of sharing arrangement should be established?

Answer. Our view is that the proceeds of the sale should be accounted for as receipts available to reduce the current budget deficit and, therefore, they should flow to the general fund without restriction. As to any subsequent appropriation by separate process, we would remind the Committee that the funding for Conrail's operating deficits and physical rehabilitation came almost entirely from the Federal purse, prior to enactment of the Northeast Rail Service Act in 1981.

Question. With respect to the divested lines, who determined precisely which routes would be offered by Norfolk Southern? Have your engineers surveyed the conditions of these lines and found them to be in the same condition as Conrail mainlines? Have your traffic people analyzed the level of traffic that will be carried on these lines, if so, can you provide those analyses to the Committee?

Answer. The Justice Department defined certain markets in which the Norfolk Southern-Conrail acquisition would reduce the number of competing carriers from 3 to 2, or from 2 to 1. It required that a new carrier be brought into those markets to restore competitive access to its premerger level. This carrier must be vested with interconnections and financial capability sufficient to provide long-term competitive service.

While the Justice Department defined the markets which had to benefit from the divestitures, it did not mandate which lines would be subjected to the divestitutre. That determination was made in negotiations between Norfolk Southern Corporation and Guilford Transportation Industries, Inc., and the Pittsburgh & Lake Erie Railroad Co. Justice did, however, retain jurisdiction over the matter, and the Secretary cannot execute the final documents until the Antitrust Division has examined the divestiture agreement, and certified that the lines transferred do indeed satisfy Justice's requirements.

FRA is quite familiar with the condition of these lines, since FRA safety inspectors review these and all of the nation's major freight lines on an ongoing basis. They are, in our judgment, more than adequate for provision of the necessary competitive service. The following details may be helpful in illustrating why we reached that conclusion:

The lines from Buffalo-to-Cleveland and from Cleveland-to-Chicago are maintained for mainline freight operations. From Fort Wayne-to-Chicago the line is maintained for passenger service. At a minimum these lines fall into our so-called Class IV status, permitting 70 mph passenger and 50 mph freight operations. Virtually all of these lines are signalled for dual operation.

The lines to St. Louis are equipped with 115 lb mainline steel, and while they will require some maintenance, it is conventional tie work and ballast, not structural maintenance. Guilford has confirmed that its inspection of these lines is consistent with our reports, and that the required rehabilitation is well within their capabilities. Agreement to provide that rehabilitation will be a condition of the contract of sale. These lines are fully adequate to provide competitive frequent service.

On a combined basis, without the significant traffic contribution that the Guilford system would bring via its eastern connections at Buffalo, these lines currently carry about 200,000 cars annually. Properly merchandised in combination with Guilford and P&LE, these lines have enormous potential. The divestitures produce a mirror image of what was once the Nickel Plate Railroad.

The Nickel Plate reached eastern markets over friendly connections with a set of railroads whose routes are now duplicated by Guilford in the East. These same lines in conjunction with eastern connections at Buffalo produced $9 billion revenue ton miles in 1964, the year they were acquired by Norfolk and Western (now NS). At today's rates that level of activity, much of which continues to be available, would have produced $360 million in revenues.

Question. Isn't it true that the success of Guilford or P&LE on these lines is dependent on the participation of the Grand Trunk railroad which originates a large amount of auto-related traffic? How close is an agreement between Grand Trunk and the other interested parties that will ensure competition for the Midewest, shippers, and viability for the regional carriers?

Answer. There is no question that participation of the Grand Trunk Western Railroad Co. (GTW) would improve volumes, and thus lower overhead costs, on these lines. Grand Trunk Western could bring the equivalent of one and one-half to two daily trainloads of traffic to the Guilford lines. The successful operation of the new P&LE lines is not predicated on GTW traffic *per se.* Only a minimal amount of GTW traffic would flow over the P&LE section, and there is no question in our judgment that these lines are viable without that traffic. However, interesting opportunities abound for P&LE and GTW to cooperate in moving steel, chemicals, and coal to Michigan markets. While the Guilford lines, which would carry most of the P&LE traffic, would benefit from its presence, there is sufficient volume from other sources to ensure their viability even should Grand Trunk Western choose not to use this routing.

We continue to urge the parties to negotiate an agreement that would bring Grand Trunk's volume onto the lines, and believe that an agreement can be reached which addresses any competitive impact which might befall Grand Trunk, while also providing Grand Trunk with direct and time-competitive routings to Chicago and St. Louis.

Question. Have you consulted with the Department of Justice to determine if the disposition of divested lines to Guilford and P&LE meets the requirements set forth in the Department of Justice's report?

Answer. The Guilford and P&LE agreements will be forwarded to the Justice Department for review in accordance with ground rules established by the Antitrust Division in its January memorandum. On the basis of routings, the lines to be divested address the bulk of the problems found by Justice. Justice is now beginning a process of examining the acquiring carriers' plans in detail and weighing their long-term viability, two of the qualifications which Justice has placed on their approval of the divestiture plans.

Question. Will you conclude the sales agreement in the absence of an accommodation with the employees and with Grand Trunk?

Answer. We have not yet had to confront that issue. We remain quite optimistic that agreements can be reached both with labor and with Grand Trunk Western.

The CHAIRMAN. The next witness is Mr. J. Paul McGrath, Assistant Attorney General in charge of the Antitrust Division at the Department of Justice. Mr. McGrath.

STATEMENT OF J. PAUL McGRATH, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. McGRATH. Good morning, Mr. Chairman. It is a great pleasure to be here this morning to discuss the antitrust analysis that the Department of Justice did of the proposed sale of Conrail to Norfolk Southern. As the Secretary has indicated this morning, she asked the Antitrust Division to review the competitive issues that might arise from this proposed sale.

Our conclusion is that the sale to Norfolk Southern of Conrail, with the divestitures that have been agreed to by Norfolk Southern and the Department of Transportation, would pose no competitive problem. I note that the Department of Justice continues to have not only the right, but also the obligation, to approve or disapprove the actual terms of any divestiture arrangements.

Mr. Chairman, we have supplied written testimony and also a copy of my report to Secretary Dole for the record, and those papers explain our antitrust analysis in some detail. I do not plan this morning to go through all that detail. What I would like to do instead is to summarize what seemed to me to be the important points of our analysis and of our conclusions.

I should point out that it was late last summer, when it became clear that Norfolk Southern was a finalist in the race to acquire Conrail, that Secretary Dole asked me to have the Antitrust Division review the competitive issues that might be raised, and it was clear that there were significant competitive issues. In particular, a sale of Conrail to Norfolk Southern would reduce from three to two the number of railroads that serve a large portion of the Northeast.

I want to emphasize that the review we did was totally independent. At no time did I receive any views from Secretary Dole or Deputy Secretary Burnley, who were the two people that I principally dealt with at the Department of Transportation, on our competitive analysis, and we did not supply the Department of Transportation with a draft of our competitive analysis before they received the final version.

Over the 4 months following Secretary Dole's request to us, we conducted what I would call a normal antitrust review of the proposed sale. We looked at whether there were competitive problems raised by the proposed sale, and we also looked to see whether there was an agreeable way to solve those competitive problems, such as through divestiture. That is the normal path we follow in reviewing any proposed merger.

We used for this task the lawyers in our Transportation Section and economists in our Economic Policy Office, who have extensive experience in railroad mergers. They applied the same legal and economic principles that have been employed in mergers generally by the Department of Justice, and in railroad mergers in particular, in proceedings before the ICC.

We used our normal information sources and our normal investigative techniques, including the gathering of data from more than 200 shippers who have used Norfolk Southern or Conrail.

The study reviewed the market involved in great depth, and in general what we did was to look at each point in the Conrail and Norfolk Southern service areas, and also each geographic point outside of those areas, to see whether the combination of the two railroads could result in the combined company having some kind of a lock on competition on shipments either into the area or out of the area.

In each case we reviewed movements on a commodity-by-commodity basis. We also reviewed actual and potential competition from other transportation modes, especially trucks, and the effect of the merger on other railroads.

The conclusions of our Transportation Section and our Economic Policy Office were these: A merger of Norfolk Southern and Conrail without any divestiture indeed raised possible competitive problems at a number of origin and destination points involving movement of commodities as to which Conrail and Norfolk Southern participated in rail revenues of $516 million in 1983, and that was roughly 7 or so percent of Norfolk Southern-Conrail combined revenues in 1983.

Now, it is true that substantial efficiencies were claimed by Norfolk Southern as flowing from the proposed transaction. But our conclusion was that those planned or proposed efficiencies were not sufficient to overcome this substantial anticompetitive competitive problem.

However, on further analysis our staff also concluded that there was a relatively straightforward way to solve the competitive problems that had arisen, through divestitures that would in effect set up new competition in the corridor bordered on the east by Buffalo and Pittsburgh and on the west by Chicago and St. Louis.

This divestiture plan would not directly touch all origin and destination points with competitive problems. But it would solve or alleviate the vast bulk of competitive problems. And in addition, those efficiencies that were likely to result from the merger were sufficient to balance or overcome any remaining possible competitive problems.

After I studied this proposal extensively, I concurred in the recommendation that was made. First, I agreed that without divestiture the competitive problems raised by the transaction were enough to raise a negative vote from us on the merger.

But second, I concluded that the proposed divestiture solution did sufficiently resolve the competitive problems we saw. First, divestiture would preserve the presence of three competitors in the areas of most significant Conrail-Norfolk Southern overlap, and would permit carriers operating outside of the main Norfolk Southern-Conrail area entry into the area through so-called friendly connections.

The divestiture would completely solve any competitive problems that we found in a number of counties by providing a new competitive rail link to those counties. That would deal with approximately $374 million of the $516 million of so-called problem revenues.

In addition, almost $94 million of the remaining problem revenues relates to shipments from counties outside of the Norfolk Southern-Conrail operating area. Since the vast bulk of these shipments are to the corridor where divestiture is required, divestiture will substantially alleviate that problem also.

That left 10 counties with $49 million of Norfolk Southern-Conrail revenues in Norfolk Southern-Conrail operating areas which would not be directly affected by divestiture. These counties' shipments, into or out of these counties, could not be directly hooked into the divested lines because it was physically impossible or because the revenues involved were simply insufficient to make such a hookup practical.

I decided, however, that this remaining loose end should not be permitted to scuttle the whole transaction, because the revenues involved were less than 1 percent of total Norfolk Southern-Conrail revenues; and second, because after divestiture shippers from those counties could move readily, or at least more readily, by truck to the competitive area created by the divestiture, should it happen that the merged railroad tried to increase its rates artificially to those isolated counties.

And in addition, even though we thought the efficiency claims made by Norfolk Southern for this merger, which exceeded $100 million a year, were somewhat overstated, nevertheless we concluded it was most likely that a portion of the efficiencies would be realized, especially efficiencies resulting from longer end-to-end runs, after the merger of the two railroads, and those efficiencies would at least balance any possible anticompetitive effect.

Thus, I agreed with the staff's conclusion that the proposed divestiture would preserve competition and that it would retain at least roughly the same overall competitive level.

I should emphasize again that the Department of Justice will have a final voice of approval or disapproval on the parties to any divestiture and on the terms of any divestiture. And thus, my conclusion this morning is that the solution which we have proposed and which has been agreed to by Conrail and Norfolk Southern and the Department of Transportation is a practical resolution to a very complex problem; that under this solution competition will not be diminished, and we will assure appropriate divestitures.

And finally, and perhaps most important of all, under this solution the efficiencies and any other public benefits that will arise from this merger can be accomplished without the overall lessening of competition.

I thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. McGrath.

In your letter to Secretary Dole, the first criterion that you set forth for divestiture is that the acquiring company possess the managerial, operational, and financial ability necessary to compete effectively and to maintain a viable entity providing long-term rail service along the designated corridor.

To have a divestiture take place and to have the track that has been turned over to another railroad continue to be used are not necessarily the same thing. How do you anticipate assuring, or is there any way to assure, that today's divestiture is not tomorrow's abandonment?

Mr. McGRATH. This is an issue we face in most divestitures in merger situations. We want to make sure that the divested assets will indeed be operated effectively and competitively, because otherwise the point of divestiture is lost.

Now, in this situation what we need to do is to study the proposals that have been made, and there are some agreements in principle that have been reached.

We will have to look at the managerial background of the companies involved, any changes they propose to make, not only their past financial history, but any additional financial backing they bring to this new arrangement, their operational plans, and in addition the exact nature of the divestiture and the divestiture agreements, to make the best judgment we can as to whether the resulting entity, be it a combination of an existing railroad with this divested entity or some other combination, is likely to withstand the difficulties of competing against the existing railroads there.

In this connection, we plan to use the same people that we used on the earlier review. We also plan to use our financial unit in the Antitrust Division, which typically undertakes tasks like this in other merger situations. We plan, obviously, to obtain the views of the U.S. Department of Transportation.

We also plan to look to the views of any State department of transportation or similar groups on this and other questions. It will be, obviously, a review that we will do independently and one that we will only indicate a conclusion on when we are satisfied with it.

The **CHAIRMAN**. CSX has expressed its opposition to the acquisition of Conrail by Norfolk Southern. Has the Justice Department examined the effect of the acquisition on CSX? Do you have an opinion?

Mr. **MCGRATH**. Yes, we have. We examined the effect of the acquisition on all neighboring rail carriers. The principal kind of effect that a merger such as this can have is it can divert traffic from a railroad other than the merging railroads, and that was obviously the principal kind of effect we looked at.

And our conclusion was that any diversions from neighboring railroads that might occur in general would be counterbalanced by the fact that gateways would be opened and the divestiture would permit there to be friendly connections to the carrier or carriers that took over the divested lines; and that after such divestiture, in the case of CSX, any remaining diversions would be such a small percentage of the $9 billion a year revenues of that railroad that you would need a pretty big chart if you were going to show one against the other in a bar chart, for instance.

We did not think it was a problem, that is, a meaningful problem.

The **CHAIRMAN**. CSX has been in the merger business also, has it not?

Mr. **MCGRATH**. They have, and they know the business very well from the other side. And they are a good, strong competitor, and obviously it is very important from our point of view that they remain a good strong competitor, an efficient, strong competitor.

And so if our conclusion had been otherwise as to CSX or any of the other trunk line carriers in the area, then we would have had quite different concerns that we would have had to sort out with respect to this acquisition.

The **CHAIRMAN** Senator Hollings.

Senator **HOLLINGS**. Well, Mr. Chairman, with respect to the merger to create CSX—the Seaboard System and the Chessie Railroad—I take it the Justice Department studied it.

And of course now the question is, did you use the same measure of study with respect to this particular merger of Norfolk Southern and Conrail? Some have contended that the evaluation of this particular merger differed from other analyses. What is your response to that?

Mr. **MCGRATH**. Well, Senator, I cannot tell you exactly how many people worked on the other transaction and so on. I can tell you two things about this one.

First, we did this as thoroughly—indeed, I think probably more thoroughly, in a way—than other mergers that we do, because it was fairly clear from day one that there would be, shall I say, more public scrutiny of this one than some other ones. And when you know that is going to be the case, you perhaps are a little more careful to dot the "i's" and cross the "t's."

One difference is that in ICC proceedings, it is frequently the case that the proceeding on a merger lasts longer, that the work you do may go over 9 months or 12 months or 15 months. And so it may be that from beginning to end studies done in other contexts, in the ICC context, last longer.

Here, of course, we did not have ICC time limits, which in effect indicated that it would take that long. The amount of time from beginning to end we spent here was similar to what we spend in all non-ICC mergers under the Hart-Scott-Rodino Act.

The amount of time we put in on it was probably somewhat greater, because I made this the number one top priority in our division because of the public importance of the transaction.

Senator HOLLINGS. Thank you very much, Mr. Chairman.

The CHAIRMAN. Mr. McGrath, thank you very much.

[The statement follows:]

STATEMENT OF J. PAUL McGRATH, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. Chairman and members of the committee, I am delighted to be here this morning to discuss the Justice Department's antitrust analysis of the proposed sale of Consolidated Rail Corporation to Norfolk Southern Corporation. Placing Conrail back into private hands is an extremely important and laudable goal. I believe an appropriately structured sale, sensitive to competitive concerns, may significantly benefit shippers currently served by the two railroads.

My remarks today will briefly summarize the Department's analysis of the competitive implications of the proposed sale and the nature of the divestiture we have recommended. The substance of our study and recommendations is set forth in more detail in my letter of January 29, 1985 to Secretary Dole, a copy of which has been provided to the Committee.

On the basis of our independent investigation, the Department has concluded that the sale of Conrail to Norfolk Southern can be accomplished without significant adverse competitive effects only if appropriate divestitures are made. Without appropriate divestitures, the sale would have a significant adverse effect on competition for the transport of certain commodities to and from a number of locations in several states, with the greatest impact occurring along an east-west rail corridor running from Buffalo and Pittsburgh in the east and East St. Louis and Chicago in the west. While the merger likely would result in certain significant efficiencies, these efficiencies do not appear to be sufficiently great to warrant approval of the merger if no divestiture is made. The Department of Justice therefore would oppose the proposed sale unless the greatest amount of its competitive problems as possible are remedied through a prior or concurrent divestiture of assets that is approved by the Attorney General.

The staff of the Antitrust Division's Transportation Section and Economic Policy Office analyzed this proposed merger using the same standards and principles generally applied to rail mergers. As with any merger, the first step was to identify economically relevant markets in which both Conrail and Norfolk Southern compete. An economically relevant market for antitrust purposes was a product and location combination which could be subject to the exercise of market power. For example, as you can see in Attachment B to my January 29 letter, iron and steel coming out of Jefferson County, Ohio was identified as one of the relevant markets.

The next step was to identify those markets in which the sale would significantly reduce competition—i.e., markets in which the sale would significantly increase rail concentration and in which competition from other existing transportation alternatives and entry by new competitors (for example, trucking companies) would be difficult or unlikely in response to the exercise of market power following the merger.

The staff identified more than 100 markets located in 39 counties and 21 states in which it appeared that the proposed sale could have a significant anticompetitive effect. With respect to these markets, Conrail and Norfolk Southern participated in rail movements involving $516.1 million in rail revenues in 1983. In conducting its analysis, the staff relied upon, among other things, 1977 Census of Transportation data, computer tapes from Norfolk Southern and Conrail containing data on 100 percent of the shipments carried by each of them in 1983, the ICC's 1983 national sample of railroad waybills, and surveys and interviews with over 200 shippers concerning approximately 700 facilities.

Having identified the markets in which the merger could have a significant anticompetitive effect, the staff considered whether these anticompetitive effects might be offset by efficiencies resulting from the merger. Some of the efficiency claims made by Norfolk Southern may either have been overstated or could have been achieved without the merger. However, the staff believed, based in part on information supplied by Norfolk Southern and interviews with affected shippers, that substantial benefits would likely result from increased single-line service, an option that is in many cases both less costly to railroads and more desirable to shippers. The staff concluded that while these benefits would not be sufficiently great to outweigh the serious anticompetitive effect the sale would have absent divestiture—particularly in the east-west corridor—they were likely to offset the less significant adverse competitive effects that would remain possible after divestiture.

Finally, the staff considered what would be required to resolve the anticompetitive problems that were raised by the merger. They concluded that appropriate divestiture of Conrail and/or Norfolk Southern rail assets along the designated east-west corridor should be made to one or more independent acquirers, other than CSX or any entity owned or controlled by CSX, that would provide long-term, viable, competitive rail service similar to that now provided by Conrail and Norfolk Southern to locations along that corridor. Such a divestiture by and large would preserve competition that otherwise would be eliminated by the proposed sale. While there may be some possible anticompetitive consequences in some isolated markets after the sale and divestiture, these anticompetitive consequences are likely to be insignificant relative to the merger's expected efficiencies and the overall volume of commerce involved in the merger.

To ensure competitive service, the divestiture must satisfy three conditions. First, the acquirer (or acquirers) must demonstrate to the Attorney General's satisfaction that it possesses the managerial, operational, and financial capability necessary to compete effectively, and to remain a viable entity providing long-term rail service along the designated corridor.

Second, the divestiture should provide the acquirer direct, independent connections in the Buffalo, Chicago, Toledo, and East St. Louis gateways to one or more railroads other than the merged railroad or CSX Corporation or any railroads owned or controlled by them. This condition is essential to the competitive viability of an alternative rail line because traffic to and from the markets affected by the merger moves not only on Conrail and Norfolk Southern, but also, to a significant extent, off those lines to or from connections with other railraods at those gateways.

Third, in order to provide shippers with effective competitive access to the track and facilities of the acquirer, following divestiture, in each of certain designated counties in the east-west corridor, the merged Norfolk Southern/Conrail entity must switch cars between its tracks and the tracks and facilities of any shipper served by Norfolk Southern, Conrail, or the combined entity on customary terms and conditions whenever switching is practicable and necessary.

These conditions of divestiture have been set forth in language agreed to by the Departments of Justice and Transportation which would be included in the Agreement of Sale between Norfolk Southern and the Department of Transportation.

The specific rail tracks and facilities to be divested and the consideration to be paid should be determined by agreement to the parties to the divestiture so that the market, rather than the Department of Justice, can determine the most suitable divestiture alternative. However, as I have stated, the ultimate divestiture would be subject to the Attorney General's approval. To assist the Attorney General in evaluating the divestiture, the Department of Justice will be supplied with complete information concerning all offers and inquiries received in connection with the divestiture, including those that are rejected by either the Department of Transportation or Norfolk Southern.

Mr. Chairman, that completes my prepared remarks. I would be pleased to respond now to any questions you or the Committee members may have.

Thank you.

(The following information was subsequently received for the record:)

U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General

Washington, D.C. 20530

January 29, 1985

Honorable Elizabeth H. Dole
Secretary
Department of Transportation
Washington, D.C. 20590

Dear Secretary Dole:

This letter sets forth the Department of Justice's analysis of the competitive implications of a proposed sale of Consolidated Rail Corporation ("Conrail") to Norfolk Southern Corporation ("Norfolk Southern"), as you requested on September 11, 1984. As explained below, on the basis of our independent investigation, we have concluded that, without appropriate divestitures, the proposed merger would violate both Clayton Act and Interstate Commerce Act merger review standards. The merger would have a significant adverse effect on competition for the transport of commodities to and from a number of locations in several states, with the greatest adverse effect occurring at locations along an east-west rail corridor running between Buffalo and Pittsburgh in the east and St. Louis and Chicago in the west. The merger would likely enable the merged entity to achieve certain efficiencies. These efficiencies do not appear, however, to be sufficiently great to offset all of the competitive effects in all of the affected markets.

The Department of Justice therefore would oppose the proposed merger unless its competitive problems are remedied through a prior or concurrent divestiture of assets 1/ that is approved by the Attorney General. Appropriate divestiture must include divestiture of Conrail and/or Norfolk Southern rail assets along the designated corridor to one or more independent acquirers, other than CSX or any entity owned or controlled by CSX, that would provide long-term, viable, and competitive rail service to locations along the corridor. Such divestiture would preserve the vast bulk of the competition that would

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1/ "Divestiture" means the conveyance or other transfer by sale, lease, or otherwise of rail tracks and facilities or the right to use rail tracks and facilities.

have been eliminated by the merger. While there may be some possible anticompetitive consequences remaining in some isolated markets after the divestiture, these anticompetitive consequences are likely to be insignificant relative to the merger's expected efficiencies. This precondition to approval of the merger has been set forth in language agreed to by the Departments of Justice and Transportation (attached to this letter as Appendix A) which is to be included in the Agreement of Sale between Norfolk Southern and the Department of Transportation.

Our analysis is explained in detail below.

I. Competitive Analysis

A. Analytical Approach

Although mergers play a beneficial role in our economy, they sometimes may harm competition by creating, enhancing, or facilitating the exercise of "market power." "Market power" is the power of a firm or firms to raise the price of a product or service in a specific market above a competitive level for a significant period of time without fear that existing competitors or new entrants will make such a price increase unprofitable by expanding their output or charging a lower price. When only a few firms in a market into which entry is difficult account for most of the sales of a product, they may either explicitly or implicitly coordinate their actions to eliminate rivalry on price and non-price variables. When firms exercise market power in this way, the result is a transfer of wealth from buyers to sellers and a misallocation of resources that harms the economy. Therefore, a merger that would eliminate a significant competitor in an already highly concentrated market into which entry is difficult may enhance the ability of the remaining firms to exercise market power. Such a merger normally would be challenged by the Department under Section 7 of the Clayton Act unless other economic factors or some appropriate divestiture indicate that the merger should be permitted. 2/

2/ See, U.S. Department of Justice, Merger Guidelines, June 14, 1984. The standards used by the Department to analyze mergers under the Clayton Act are substantially the same as those used by the Interstate Commerce Commission, which is directed by statute to approve only transactions that are "consistent with the public interest." 49 U.S.C. § 11344. In applying this standard, the Commission disapproves transactions that would "substantially reduce the transport alternatives available to shippers unless there are substantial and demonstrable benefits to the transaction that cannot be achieved in a less anticompetitive fashion." General Policy Statement for Merger on Control of at Least Two Class I Railroads, 49 C.F.R. § 11801(a).

We analyzed this proposed merger according to the same standards and principles that we apply to mergers generally. As with any merger, our first step was to identify economically relevant markets--product-location combinations which could be subject to the exercise of market power--in which both Conrail and Norfolk Southern operate. Our next step was to identify "problem" markets (i.e., product-location combinations) with respect to which the merger would result in significantly high post-merger concentration and where entry by new firms (for example, trucking companies) would be difficult or unlikely in response to the exercise of market power following the merger. Once we identified the markets in which the merger would likely have a significant anticompetitive effect, we then considered whether these anticompetitive effects might be offset by efficiencies resulting from the merger. Finally, we considered what would be required to resolve any competitive problems that might be raised by the merger--that is, to prevent a reduction in the number of competing rail alternatives in highly concentrated markets where considerable revenues are involved and where the merger would otherwise be likely significantly to diminish competition.

B. Methodology

We defined two types of economically relevant markets for the purpose of analyzing this proposed merger-- (1) transportation of a commodity to a location ("destination markets") and (2) transportation of a commodity from a location ("origin markets"). 3/ In addition to railroads, non-rail

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3/ We identified commodity and location combinations using the five-digit Standard Transportation Commodity Codes ("STCCs") and four-digit Standard Point Location Codes ("SPLCs"), respectively, designated in the 1983 ICC 1% Waybill Sample. Five-digit STCCs were used because, for the most part, the products in a single five-digit group are close substitutes for one another and have similar transportation characteristics. A four-digit SPLC is in most cases a county, although, in a significant number of cases, a single county may contain two or more four-digit SPLCs.

Usually, the relevant geographic market will be as small as a county. However, even if in some cases the market may be broader, the competitive analysis would be the same because in markets located along the east-west corridor towards which our proposed remedy is directed, there are at most four competing railroads before the merger. In addition, where we knew with some certainty that the market was broader than a county, we incorporated this into our analysis. For example, we analyzed separately outbound shipments of corn, wheat, and soybeans, as well as the movement by rail of coal to utility plants. Producers of these commodities tend to be able to select among transportation alternatives that extend beyond county lines through the use of a combination of rail and nonrail movements.

result from the merger and given the fact that the commerce affected as to these 15 counties is so small compared to the actual overall volume of commerce involved in the merger. Even after eliminating these counties, however, a number of others remain and the potentially affected revenues in these counties are substantial enough to be of significant concern. The remaining counties include, among others, Wayne and Washtenaw counties in Michigan; Allen and Marion counties in Indiana; Erie county in New York; and Cuyahoga, Jefferson, Lucas, Stark, and Lorain counties in Ohio, as well as several counties in the southern United States that originate shipments of pulp, paper, and fiberboard products destined for locations served by Norfolk Southern and/or Conrail in the Midwest and Northeast. 5/ In two of these counties, Jefferson county in Ohio and Allen county in Indiana, our concern is particularly acute because the number of competing railroads would be reduced from two to one. In the other counties, the competitive situation would not be much better, because the number of rail alternatives would be reduced either from three to two or from four to three. We have determined that, although they are used by shippers to some limited extent, non-rail transport alternatives are inadequate substitutes for rail transport in these markets.

We also considered the argument that following the merger, the combined entity would divert so much interchange traffic from regional railroads in the northeast and midwest that some of these railroads would be unable to compete effectively in the markets they currently serve and that the resulting loss of competition would reduce consumer welfare. We find, however, that, as a general matter, it is extremely difficult to estimate the size of future diversions. 6/ It may be even more difficult to determine whether such diversions would be so substantial as to render otherwise viable regional railroads incapable of providing competition in markets where they currently operate and where their exit would reduce competition significantly. Because diversions often result from lower costs to railroads of providing single-line, rather than interline, service and because single-line service is often attractive to shippers, any potential harm in markets currently served by regional carriers

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5/ A complete listing of the product-location combinations identified through our screening methodology is attached to this letter as Appendix B. This listing is limited to counties in which in 1983 the potential problems identified involved Norfolk Southern's and Conrail's participation in rail revenues exceeding $2 million.

6/ While we have received diversion estimates from a number of sources, including the Department of Transportation, Norfolk Southern, Conrail, and some regional carriers, these estimates vary considerably and it is very difficult to draw firm conclusions from them.

transportation modes, such as truck and barge, were considered to be in the market to the extent they appeared to be close substitutes for rail transportation.

To identify those markets in which the merger might have a significant adverse effect (i.e., would result in high post-merger concentration and would significantly increase pre-merger concentration), we first identified markets (product-location combinations) where in 1983 Conrail and Norfolk Southern each participated (independently of one another) in at least 10 percent of the rail movements and where together the two railroads accounted for at least 50 percent of all rail movements in the market. 4/ Using 1977 Census of Transportation data, supplemented by surveys and interviews with over 200 shippers concerning approximately 700 facilities, we then eliminated those markets where non-rail competition appeared to be significant. Finally, we employed a number of other screens designed to eliminate from further consideration those markets in which over a significant portion of the route into the destination or out of the origin market in question, a single carrier other than Conrail or Norfolk Southern provides rail service, in which the total revenues affected were small, or in which the major shipper in the market supported the merger.

Using this screening procedure, we identified more than one hundred markets located in 39 counties in 21 states in which it appeared that a merger between Conrail and Norfolk Southern could have a significant anticompetitive effect. With respect to these markets, Conrail and Norfolk Southern participated in movements involving $516.1 million in rail revenues in 1983. Of the 39 counties, 15 had "problem" markets in which Conrail or Norfolk Southern participated in movements involving less than $5 million of revenues. If these 15 counties had been the only locations potentially affected by the merger, we would not oppose the merger, given the likely efficiencies that would

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4/ Although in some of the markets shippers can now be served only via the tracks of either Conrail or Norfolk Southern, but not both, many of these shippers nevertheless consider other carriers identified on the Waybill to be competitive alternatives because of "reasonable" reciprocal switching arrangements currently in place. One factor that probably keeps the switching rates of Norfolk Southern and Conrail low enough to allow competition in these markets is the fact that the two carriers rely on each other for switches into different markets and each might feel constrained from unilaterally exercising its full market power (by raising the switching rates at locations it alone controls) for fear that the other railroad would retaliate in other locations. Thus, even where shippers can be reached only by the tracks of Conrail or Norfolk Southern, the merger may eliminate competition that resulted from reciprocal switching.

must be weighed against possibly substantial benefits. Hence, even if we knew with certainty that such diversions would significantly impair the operations, or even the viability, of regional railroads, this would not demonstrate that the diversions are, on balance, harmful to the economy. To the extent that they may be harmful, however, the divestiture that we have proposed in Section II of this letter would address that problem by ensuring that there will be an opportunity for regional carriers to continue receiving interline traffic from independent carriers other than Norfolk Southern or Conrail.

C. Efficiencies

The primary benefit of mergers to the economy is their efficiency-enhancing potential, e.g., their ability to lower overall production costs to the benefit of society. Some mergers that would significantly increase concentration in a market nevertheless result in significant real efficiencies. Therefore, if the parties to a merger establish by clear and convincing evidence that a merger will achieve such efficiencies, the Department considers those efficiencies in evaluating the merger.

As stated in the Department's Merger Guidelines, 7/ cognizable efficiencies include, but are not limited to, economies of scale, better integration of operating facilities, and similar efficiencies relating to specific operations of the merging firms. The Department also considers claimed efficiencies resulting from reductions in general administrative and overhead expenses, and other efficiencies that otherwise do not relate to specific operations of the merging firms, although, as a practical matter, those types of efficiencies are more difficult to demonstrate and to quantify. The Department does not give weight to claimed efficiencies if comparable savings reasonably could be achieved by the parties through means short of a merger likely to reduce competition.

We have reviewed efficiency claims made by Norfolk Southern. We believe that some of these claims are overstated, 8/ while others, such as abandonment of unprofitable track, would probably occur even in the absence of a merger. Nevertheless, we believe, based in part on interviews with affected shippers, that substantial benefits are likely to

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7/ U.S. Department of Justice, Merger Guidelines, June 14, 1984, at Section 3.5.

8/ For example, Norfolk Southern's estimated annual savings of $139 million due to the elimination of redundant personnel and facilities is highly speculative given the unpredictable results of union labor negotiations.

result from increased single-line service, an option that is in many cases both less costly to railroads and more desirable to shippers.

On balance, we have concluded that the possible benefits of the proposed merger are not sufficiently great to outweigh the very serious anticompetitive effect the merger would have, particularly in the designated east-west corridor. The potential efficiency gains--particularly relating to the offering of single-line service--are, however, likely to be sufficiently great to offset the less significant adverse competitive effects that would remain after the divestiture outlined in Section II of this letter is effected.

II. Proposed Remedy

As discussed above, although the proposed merger would have an anticompetitive effect in a number of markets, the markets of primary concern are located along a rail corridor bounded on the east by Buffalo and Pittsburgh and on the west by Chicago and St. Louis. Accordingly, we believe that a sale of Conrail to Norfolk Southern must be expressly conditioned on the prior or concurrent divestiture 9/ of rail assets to an independent entity or entities capable of providing long-term, viable, and competitive rail service along this corridor. For these purposes, "divestiture" means the conveyance or other transfer by sale, lease, or otherwise, of rail tracks and facilities or the right to use rail tracks and facilities.

To ensure competitive service, the divestiture must satisfy three conditions. First, the acquirer or acquirers (hereinafter "acquirer") must demonstrate to the satisfaction of the Attorney General that it possesses the managerial, operational, and financial capability necessary to compete effectively, and to remain a viable entity providing long-term rail service along the designated corridor.

Second, the divestiture should provide the acquirer direct connections in Buffalo, Chicago, Toledo, and East St. Louis to one or more railroads other than the the merged carrier or CSX Corporation or any railroad controlled by either of them. This condition is essential to the competitive viability of an alternative rail line because traffic to and from the affected markets moves not only on Conrail and Norfolk Southern lines, but also, to a significant extent, off those lines to or from

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9/ Concurrent divestiture may involve a transaction such as a contract between Norfolk Southern and a purchaser to transfer assets acquired from Conrail. Such a contract could become effective as at the closing of the sale of Conrail to Norfolk Southern.

connections with other railroads in Buffalo, Chicago, Toledo, and East St. Louis. Therefore, an independent connection to other railroads at each of these gateways would have to be available so as to remove the acquirer's need to rely upon the merged carrier or CSX to make these connections. 10/

Third, following the divestiture, in each of the designated counties in the east-west corridor, the merged Norfolk Southern/Conrail entity must switch cars between its tracks and facilities and the tracks and facilities of any shipper served by Norfolk Southern, Conrail, or Norfolk Southern/Conrail on customary terms and conditions whenever switching is practicable and necessary in order to provide a shipper with effective competitive access to the track and facilities of the acquirer.

The specific rail tracks and facilities to be divested and the consideration to be paid should be determined by agreement between the parties to the divestiture so that the market, rather than the Department of Justice, can determine the most suitable divestiture alternative. Because the divestiture would be subject to the Attorney General's approval, however, to assist him in evaluating the divestiture the Department of Justice should be supplied with complete information concerning all offers and inquiries received in connection with the divestiture, including those that are rejected by either the Department of Transportation or Norfolk Southern. 11/

This proposed divestiture addresses the vast majority of the larger "problem" markets we identified. While several markets are not affected by the proposal, these markets are either located in areas where a divestiture would be impractical or are locations where the amount of commerce shared by Conrail and Norfolk Southern was less than $5 million. When an independent rail alternative able to maintain competition within the designated corridor is found, such divestiture would resolve at least $371.4 million of potential problems out of a total of $516.1 million in the markets we have identified. In addition, this remedy would benefit some shippers, such as pulp, paper, and fiberboard producers located in 11 "problem" counties in the South, whose goods pass through or terminate in this corridor.

10/ The Toledo gateway would give shippers in Wayne and Washtenaw counties in Michigan access to a railroad other than Norfolk Southern/Conrail and CSX that provides a direct link to eastern and western destinations via Buffalo, Chicago, and East St. Louis.

11/ These terms and conditions are set forth in Appendix A and, we understand, will be included in the Agreement of Sale between the Department of Transportation and Norfolk Southern.

Finally, as discussed above, we have determined that the efficiencies that are likely to result from the proposed merger would be substantial enough to offset the potential anticompetitive effect in markets that are not directly addressed by the proposed divestiture.

III. Conclusion

I trust that this letter is responsive to your request for the Department's advice concerning the competitive impact of a sale of Conrail to Norfolk Southern. I would like to thank you and your staff for the competent and willing assistance that has been provided to us throughout our review process.

Sincerely,

J. Paul McGrath/D.G.

J. Paul McGrath
Assistant Attorney General
Antitrust Division

Attachment A

"Divestiture" means the conveyance or other transfer by sale, lease, or otherwise of rail tracks and facilities owned or operated by CR or NS or the right to use such rail tracks and facilities.

"NS" means Norfolk Southern Corporation, its subsidiaries, affiliates, successors and assigns.

"CR" means Consolidated Rail Corporation, its subsidiaries and affiliates.

"CSX" means CSX Corporation, its subsidiaries, affiliates, successors and assigns.

1. This Agreement of Sale is contingent upon prior or concurrent Divestiture sufficient to enable an acquirer or acquirers ("acquirer(s)"), not controlled as control is defined in 49 U.S.C. §10102 by NS/CR or CSX, to provide rail service along a rail corridor bounded on the West by Chicago and E.St. Louis and on the East by Buffalo and Pittsburgh, with service to, from, and between the following counties in that rail corridor: Erie, New York; Cuyahoga, Lorain, Jefferson, Lucas, and Stark, Ohio; and Allen and Marion, Indiana. Subject to the requirements of paragraph (5) with respect to Marion County, Indiana, such rail service may be limited to service along those sold or leased rail lines where prior to divestiture shippers had service by both NS and CR. Such rail service shall include direct connections in Buffalo, E.St. Louis, Toledo and Chicago to a railroad or railroads not controlled by NS/CR or CSX as control is defined in 49 U.S.C. §10102.

2. The rail tracks, rights and facilities divested pursuant to paragraph (1) and the consideration paid therefor shall be determined by agreement between NS and the acquirer(s).

3. The Divestiture required by paragraph (1) shall be made to acquirer(s) who shall have demonstrated to the Department of Justice that they will be able to provide long-term, viable, competitive rail service along the rail corridor(s) and to, from and between the counties enumerated in paragraph (1), as indicated by their having managerial, operational, and financial capability necessary to compete effectively in the provision of such rail service. The Divestiture required by paragraph (1) may not be accomplished without the prior approval by the Attorney General of its terms and conditions and of the acquirer(s).

4. Following the execution of this Agreement of Sale, NS shall promptly solicit offers to purchase, lease, or operate upon property to be divested in accordance with paragraph (1). NS shall keep records of its efforts to accomplish the Divestiture required by paragraph (1), including the identification of any person or persons expressing an interest to any officer or official of NS, and the terms and conditions of each offer, and shall allow the Department of Justice access to such records. NS shall immediately notify the Department of Justice of the details of any offer related to the Divestiture required by paragraph (1). If NS rejects any such offer, it shall promptly notify the Department of Justice and fully describe the reasons for such rejection.

5. It is further agreed that following Divestiture NS, CR, or NS/CR shall switch cars, on terms and conditions customary at other locations within the region of the Divestiture, between the tracks and facilities of the acquirer(s) and the tracks and facilities of any shipper physically served by NS, CR, or NS/CR and open to service by both as of the date hereof, at each of the counties specified in paragraph (1) whenever such switching is practicable and necessary in order to provide a shipper with effective competitive access to the tracks and facilities of the acquirer(s). Following Divestiture, in Marion County, Indiana, NS, CR or NS/CR shall establish switching charges at levels no higher than those customarily charged at other locations within the region of the Divestiture for switching cars between the tracks and facilities of the acquirer(s) and the tracks and facilities of any shipper served by NS, CR or NS/CR as of the date hereof. If there is a dispute as to whether such switching is practicable and necessary, or as to such customary conditions and compensation for such switching, such dispute shall be resolved within six months by an arbitration procedure governed by the rules of the American Arbitration Association. In respect of such requirements for practicable and necessary switching of cars, the acquirer(s) and the directly affected shipper(s) shall be entitled to enforce this paragraph, in each such instance, for their sole benefit.

U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General

Washington, D.C. 20530

APR 8 1985

Honorable John C. Danforth
Chairman, Committee on Commerce,
  Science & Transportation
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This letter responds to your letter of March 8, 1985, concerning the Department of Justice's analysis of the competitive effects of the proposed acquisition of Conrail by Norfolk Southern. In your letter you requested that we address several contentions raised by Mr. Kelvin Dowd of the Eastern Coal Transportation Conference and Mr. Hays Watkins of CSX Corporation. You also asked us to respond to five questions from Senator Trible enclosed with your letter.

First, in his testimony to the Committee, Mr. Dowd stated that the Justice Department's analysis of the competitive impact of the Norfolk Southern purchase contains "significant deficiencies and omissions . . . which seriously impugn the credibility of its conclusions." The major "deficiencies and omissions," according to Mr. Dowd, are: (a) the scope of the Department's analysis of competitive markets is overly narrow because it is based on the so-called "50/10 test" rather than the Herfindahl-Hirschman Index (HHI) threshold used to measure market concentration in the Department's Merger Guidelines; (b) the Division's diversions analysis; (c) the Division's screening procedure; and (d) the Division's failure to consider the potential impact of the acquisition on coal transportation, particularly export coal.

With respect to Mr. Dowd's first contention, the Department of Justice has never applied an HHI threshold in analyzing rail mergers because the HHI does not adequately measure the competitive consequences of such mergers. Using the principles of market definition found in the Merger Guidelines, we often find that in railroad mergers -- including this one -- a relevant market includes firms that provide competitive alternatives through a variety of transportation modes, including truck and barge lines as well as other railroads. The HHI is an unsatisfactory tool to use under these conditions because the company-specific data needed for HHI analysis are generally unavailable for non-rail competitors, and it is often impossible to estimate accurately the ability of non-rail competitors already serving the market to expand their shares in response to possible increases in rail rates. Conversely, since the 50/10 test is applied only to rail data, that test generally will tend to overstate the actual concentration of all competitors in a relevant market. In rail mergers, therefore, the Department uses a series of screens other than the HHI, including the 50/10 test, that in combination generate the information necessary to identify areas of competitive concern.

The Department employed the 50/10 criterion in its analyses of the Chessie/Seaboard merger and the Union Pacific/Missouri Pacific/Western Pacific merger, and we used a similar test ("50/greater than zero") in our recent analysis of the proposed sale of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company. The Department is also using a 50/10 screen as part of its analysis of the proposed Santa Fe/Southern Pacific merger. Mr. Dowd is therefore incorrect in suggesting that the Department has departed here from its standard approach to analyzing rail mergers.

Mr. Dowd's second contention concerns diversions and assumes that we ignored diversions in conducting our analysis. This assumption also is incorrect. In fact, we determined that given the proper implementation of the divestiture we have proposed, the regional carriers whose survival might have been jeopardized due to merger-related parallel diversions can continue to operate via friendly connections through which they can serve most of their current customers. The survival of carriers that will chiefly suffer diversions as a result of the end-to-end linking of rail tracks also will not be jeopardized, since traffic diversions from them are likely to be small relative to their total revenues. In short, no failures of regional carriers should result from either parallel or end-to-end diversions associated with the merger.

Moreover, end-to-end linkage is often beneficial to shippers because it enables them to reach, via single-line service, destinations that could previously be reached only through joint-line service. By eliminating the need for an interconnection and related costs, and by increasing efficiency, single-line service resulting from a merger often provides lower cost and greater convenience to shippers; in other words, diversions are often the result of informed consumer choices.

Mr. Dowd's third contention concerns the Department's screens. In particular, Mr. Dowd questioned the Department's alleged decision to exclude from consideration markets where "non-rail competition appeared to be significant," where "the major shipper in the markets supported the merger" or where "the total revenues affected were small." In fact, the Department did not exclude from consideration markets in which non-rail competition appeared to be significant. Rather, consistent with our prior rail merger analyses, we explicitly took into account intermodal competition in an effort to identify those markets in which competition from non-rail carriers would not merely be significant but would effectively curtail potential abuse of market power by railroads. We did this largely by examining highly disaggregated, commodity-specific rail and non-rail traffic data, and we sought to verify our results through the shipper surveys. To the extent that we found that other modes of transportation were not substitutable for rail transportation in problem markets we identified, we included those markets in Appendix B of Assistant Attorney General McGrath's letter of January 29, 1985, to Secretary Dole as "problem" markets. Most of the remaining problem markets involved movements of bulk commodities as to which non-rail transportation does not provide a reasonable alternative.

As for our reliance on the responses of major shippers, this too is in keeping with our normal investigation methodology. During the Antitrust Division's merger investigations, we interview customers who might be affected by the transaction to obtain knowledge about the markets involved and to ascertain the likely competitive effect of the acquisition in those markets. In this particular investigation, we used the information obtained from shippers primarily as a check on information already available to us from other sources. As a practical matter, because the rationale underlying the shippers' responses to our questions was not always clear, we rarely decided to include or exclude markets solely on the basis of opinions expressed to us by shippers. We were, however, more likely to rely on shipper responses when they brought to our attention relevant information of which we had been unaware. Moreover, even markets that were deleted based on shipper responses will often be benefitted by the proposed divestiture. For example, the divestiture specifically addresses the situation of Lorain County, Ohio, even though the shipments of a major rail user located there -- Ford Motor Company -- were deleted because Ford expressed support for the merger.

We also deleted from our list of problem markets certain markets where the "total revenues affected were small." We did this not only because it would have been impossible to analyze every market that might be affected in some small way by the merger, but also because we believed that certain efficiencies to be realized by this merger will benefit shippers as a whole to some degree. It is important to note that the problem markets eliminated in this manner were very small indeed; the annual rail revenues involved in each were less than $2 million and represent less than one train load per week for the movement of most commodities. Moreover, as Assistant Attorney General McGrath reported to Secretary Dole in a letter dated March 26, 1985, a copy of which is enclosed, the Division recently reexamined counties that are served exclusively by Norfolk Southern and Conrail. In our reexamination, we did not place a lower limit on the revenues generated annually (i.e., we did not use the $2 million/year screen). This reexamination revealed less than $1 million in additional "problem" revenues that will not be alleviated by the required divestiture.

A further comment on the use of "screens" in analyzing railroad mergers may be helpful. Large railroad mergers typically affect in some way hundreds, if not thousands, of markets involving a wide range of products in a variety of locations. Depending on the merger, some of these markets may be affected adversely due to a reduction in competition, while others are likely to benefit from improved service provided in the future by a more efficient post-merger competitor. Because of the intractability of any analysis that would seek to deal individually with the myriad of merger effects, the use of screens like those employed here is the typical mode of analysis in the context of rail mergers. At each stage of the screening procedure, markets are removed from consideration when it becomes clear that the merger is unlikely to create or worsen competitive problems. Thus, competitive problems can effectively be identified without unduly complicating and unreasonably delaying the analysis through straining to obtain data about markets for which the transaction does not pose competitive concerns.

In response to Mr. Dowd's last contention, we explicitly considered the impact of the acquisition on coal shippers and customers. The primary reason why we identified relatively few markets where the merger was likely to create a competitive problem in the shipment of coal is that Norfolk Southern and Conrail seldom compete to serve either the same coal origins or the same coal destinations. With respect to domestic coal movements in particular, we interviewed 72 utility customers that receive coal either directly or indirectly from Norfolk Southern or Conrail or both. Very few of these customers indicated that they would be adversely affected by the merger. The vast majority were already served by only one of the two railroads or were not concerned about the competitive effect of the merger because they were receiving their coal requirements by water or truck. However, we did identify several coal destinations as possible problem markets. These destinations, which are listed in Appendix B of our January 29, 1985, letter to Secretary Dole, generally represent coal moving to steel companies. Many of these steel companies were contacted and their comments were taken into account in our analysis.

As for export coal, the evidence suggests that to the extent that eastern railroads possess significant pricing power in the world market for coal (and it is questionable whether or not they do), Conrail is not a major carrier of that coal and does not provide a significant competitive check on whatever ability Norfolk Southern and CSX might already have to raise export coal rates to the disadvantage of export coal shippers. This conclusion is consistent with the findings of a 1981 National Economic Research Associates study commissioned by the Coal Exporters Association. That study determined that more than 90 percent of all export coal was at that time being carried by CSX and/or Norfolk Southern, that the projected capacity of Conrail's Philadelphia port was very small relative to the facilities of CSX and Norfolk Southern, and that coal to which Conrail's lines have access is not typically of a type demanded by foreign customers. Verified Statement of National Economic Research Associates, Inc., Railroad Exemption-Export Coal [Ex Parte No. 346 (Sub-No. 7)], filed before the Interstate Commerce Commission, December 18, 1981.

You have also asked us to comment on the testimony of Mr. Hays T. Watkins, Chairman and Chief Executive Officer of CSX Corporation, concerning a meeting that CSX representatives had with Antitrust Division personnel regarding the sale of Conrail. Specifically, Mr. Watkins testified that the Justice Department told CSX during 1984 that any bid made by CSX or Norfolk Southern for Conrail would be opposed on antitrust grounds. I understand, however, that Mr. Watkins never met with the Department on this matter and perhaps for that reason, his statement -- which apparently was based upon representations made to him by others -- is inaccurate in certain important respects.

The facts as we know them are that on April 27, 1984, Mr. Elliott M. Seiden, Chief of the Antitrust Division's Transportation Section, and members of his staff met with Messrs. John Snow and Mark Aaron of CSX in Mr. Seiden's office, at the request of Mr. Snow. At the meeting, Mr. Snow told Mr. Seiden that CSX was concerned that Norfolk Southern was seriously considering making a bid for the purchase of Conrail. Mr. Snow indicated that CSX had already analyzed whether a purchase of Conrail by either Norfolk Southern or CSX could satisfy our antitrust standards. Mr. Snow further stated that CSX had concluded that neither carrier could meet the standards that the Department of Justice had established in previous merger proceedings at the ICC. In light of this CSX analysis, Mr. Snow asked Mr. Seiden to respond to two questions: (1) Would the Department of Justice participate in the Department of Transportation's consideration of the various bids for Conrail that would be made later in the year; and (2) Would the Department of Justice support a request that CSX had contemplated making to the Department of Transportation for the convening by the Secretary of Transportation of a section 401 conference (under Section 401 of the Railroad Revitalization and Regulatory Reform Act of 1976, 49 U.S.C. §333(d)), which would have as its objective carving up Conrail into two systems, one to be controlled by Norfolk Southern and the other by CSX. Mr. Snow indicated that this could be accomplished in such a way as to enhance competition in the East by creating two-carrier service to New York and New Jersey (where one-carrier service now exists). In Mr. Snow's view, this would have compensated for the reduction in the number of competing railroads in the Midwest from three to two.

After hearing Mr. Snow's presentation, Mr. Seiden responded that the Department of Justice had not yet begun to analyze any possible rail consolidations involving Conrail since the bidding process had not been completed. Mr. Seiden emphasized that the Department's staff had done little more than look at some route maps, and therefore was in no position to assess the competitive consequences of any particular consolidation. As for the Department's participation in the DOT selection process, Mr. Seiden indicated that the Department was confident it would have a direct and substantive role in that process. He indicated, specifically, that Assistant Attorney General McGrath and Deputy Secretary of Transportation Burnley had already agreed that the Department would play a major substantive role in analyzing the competitive consequences of particular consolidations as they came to light and that the working relationship between the two Departments was excellent. Mr. Seiden concluded that Mr. Snow should be reassured that the Department of Justice's competitive analyses would indeed be brought to bear, if that appeared necessary or desirable. Finally, Mr. Seiden indicated that the possibility of convening a Section 401 conference was an idea that had not previously been broached and that he could not provide an immediate reaction. He indicated, however, that if the matter were to be given further attention, it would be considered on the merits.

In sum, at no time during this conversation or any other conversation between Department representatives and CSX did anyone from the Department express an opinion on the competitive consequences of any merger involving Conrail, much less focus on a possible CSX-Conrail or Norfolk Southern-Conrail consolidation.

As to the questions raised by Senator Trible concerning the Richmond, Fredericksburg and Potomac Railroad Company (RF&P), the Department recently has responded to most of them in a letter to Mr. John J. Newbauer, Jr., President of RF&P, a copy of which is also enclosed. In that letter, I pointed out that while the Department did not examine specifically the question whether RF&P could continue to compete on the Potomac Yard-Richmond route, we did examine the possible effect of diversions on CSX Corporation, and concluded that the diversions would not be so large as to jeopardize the railroad. We have assumed that such an analysis is sufficient with respect to RF&P since, while that railroad is only 34 percent owned by CSX subsidiaries, CSX controls 63 percent of its voting stock and provides the bulk of the railroad's traffic. As to protections that RF&P desires to have to ensure the continued flow of traffic over its lines, I can only reiterate the Department's position concerning such "DT&I conditions." Such conditions are, in effect, market allocations and pricing agreements that undermine the ability of merging carriers to realize the efficiencies that could otherwise be realized through their merger. Thus we would not suggest amendments to the Conrail legislation that would ensure that RF&P could maintain its current market position.

I trust this information fully responds to your letter and will be helpful to the Committee.

Sincerely,

Charles F. Rule
Acting Assistant Attorney General
Antitrust Division

Enclosures

U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General

Washington, D.C. 20530

MAR 20 1985

Honorable Elizabeth H. Dole
Secretary
Department of Transportation
Washington, D.C. 20590

Dear Secretary Dole:

This letter is to update you on the Department's analysis of the competitive implications of the proposed sale of Consolidated Rail Corporation ("Conrail") to Norfolk Southern Corporation ("Norfolk Southern"). As part of our continuing review of the proposed merger, we have determined that useful information on the competitive impact of this acquisition can be gained from the use of an additional screen. In particular, the staff has identified those counties where Norfolk Southern and Conrail provide the only available rail service, but where we did not detect significant competition between them through our use of the ICC Waybill sample and the 50/10 screen.

To undertake this additional analysis, the staff used the Conrail and Norfolk Southern 1983 traffic tapes. Using this data we identified every instance in these exclusively-served counties where both railroads originated or terminated the same commodities. We then applied the same screens (with the exception of the 50/10 and the $2 million minimum revenue screens) as are described in my January 29, 1985, letter to you. Using this methodology, we found that, in addition to the counties identified in my original letter, competition is likely to be reduced for movements to and from the following counties: Sandusky, Crawford and Coshocton, Ohio; and Howard, Blackford and Wabash, Indiana. These movements, which are reflected in the attachment to this letter, involve $11.3 million of problem revenues.

With respect to these movements, it appears that our proposed divestiture will provide for service to at least some of the counties. Under one proposal currently being discussed by Norfolk Southern and another carrier, we understand that all of these counties except Sandusky (which accounts for $794,108 of problem revenues) would be served by the independent entity. Since we have now identified these markets as markets which will be adversely affected, we will seek to ensure that they are served, just as we will seek to ensure that all affected counties in the divestiture corridor will be able to obtain competitive service. If this is accomplished, the proposed divestiture will assure that most shippers who would have been adversely affected by this merger will be able to continue to receive competitive service once the divestiture is implemented.

Sincerely,

J Paul McGrath

J. Paul McGrath
Assistant Attorney General
Antitrust Division

Enclosure

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                    COUNTIES SERVED EXCLUSIVELY BY NS AND CR

---------- SPLC=3659   COUNTY=HOWARD    ST=IN    TOTAL REVENUE=3721257 ----------

                         STCC5     PRODUCT

                ORIG     37149     MOTOR VEHICLE ACCESSORIE
                DEST     40211     IRON OR STEEL SCRAP,WAST
                ORIG     40211     IRON OR STEEL SCRAP,WAST
                DEST     41114     ARTICLES, USED

---------- SPLC=3479   COUNTY=COSHOC    ST=OH    TOTAL REVENUE=3369068 ----------

                         STCC5     PRODUCT

                ORIG     26311     FIBERBOARD, PAPERBOARD O
                DEST     40241     PAPER WASTE OR SCRAP

---------- SPLC=3648   COUNTY=BLACKF    ST=IN    TOTAL REVENUE=1658107 ----------

                         STCC5     PRODUCT

                DEST     26111     PULP
                DEST     26311     FIBERBOARD, PAPERBOARD O

----------- SPLC=3653   COUNTY=WABASH    ST=IN    TOTAL REVENUE=1520575 ---------

                         STCC5     PRODUCT

                ORIG     26311     FIBERBOARD, PAPERBOARD O
                DEST     32952     LIGHT WEIGHT AGGREGATES,
                DEST     40214     ALUMINUM OR ALLOY SCRAP,
                DEST     40241     PAPER WASTE OR SCRAP

------------ SPLC=3423   COUNTY=SANDUS    ST=OH    TOTAL REVENUE=794108 ---------

                         STCC5     PRODUCT

                DEST     11212     PREPARED BITUMINOUS COAL
                ORIG     32552     NONCLAY REFRACTORIES

------------ SPLC=3458   COUNTY=CRAWFO    ST=OH    TOTAL REVENUE=269663 ---------

                         STCC5     PRODUCT

                DEST     28596     BLACKS
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U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General *Washington, D.C. 20530*

APR [illegible]

Mr. John J. Newbauer, Jr.
President
Richmond, Fredericksburg
& Potomac Railroad Co.
P.O. Box 11281
Richmond, VA 23230

Dear Mr. Newbauer:

This letter responds to your March 1, 1985 letter concerning the acquisition of Conrail by the Norfolk Southern Railroad. In your letter you expressed concern about diversions resulting from this merger and their effect on your railroad. You also recommended the imposition of traffic protective conditions to remedy this effect.

The Department of Justice did consider the impact of diversions in its analysis. As we state in our letter to Secretary Dole, however, we do not ordinarily view diversions to be anticompetitive. Rather, we ordinarily view diversions as symptoms of more efficient routing created by a merger. Accordingly, diversions are not of concern to us except in those rare instances where they may be so great as to threaten the viability of an otherwise healthy regional competitor. Here we do not believe viability is at issue. Given the divestiture we have proposed in our letter to Secretary Dole, we do not believe that any regional carrier will fail as a result of diversions alone. Moreover, because of RF&P's close commercial relationship to CSX, we do not believe your railroad will fail as a result of Norfolk Southern's acquisition of Conrail.

You also requested the imposition of traffic protective conditions on behalf of RF&P. Such conditions are commonly referred to as DT&I conditions from the 1950 Detroit, Toledo and Ironton Railroad consolidation proceeding, 275 I.C.C. 455 (1950). The Interstate Commerce Commission ("ICC") routinely imposed this package of conditions upon rail mergers for many years. More recently, however, with the Department's encouragement and approval the ICC has adopted a very different attitude toward such conditions, recognizing that they create "anti-competitive consequences which far outweigh any procompetitive effects." St. Louis Southwestern Railway Company, 363 I.C.C. 323 (1980). Thus, the Commission has refused to impose new DT&I conditions and is now trying to eliminate such conditions that were imposed on previously approved mergers. Rulemaking Concerning Traffic Protective Conditions in Railroad Consolidation Proceedings, Ex Parte No. 282 (Sub. 5), 366 I.C.C. 112 (1982). The Department of Justice supports the ICC's policy, and we think it would be an anticompetitive step backwards to impose them in this merger. Therefore, we did not recommend them as part of the divestiture plan.

I hope this letter has been responsive to your questions.

Sincerely,

Charles F. Rule
Acting Assistant Attorney General
Antitrust Division

The CHAIRMAN. The next witness is Mr. Ronald Pearlman, Assistant Secretary of the Treasury for Tax Policy. Mr. Pearlman.

STATEMENT OF RONALD PEARLMAN, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. PEARLMAN. Good morning, Mr. Chairman, Senator Hollings. I am pleased to be here this morning to add to the testimony you have already received the views of the Treasury Department on the Federal income tax aspects of the proposed sale by the Federal Government of its interest in Conrail.

In preparing both the plan of sale that is under consideration and in reviewing the bids that the Department of Transportation received in connection with Conrail, the Department of Transportation requested and received from Treasury advice and consultation with respect to the Federal tax aspects.

We had two principal concerns as we reviewed the prospective sale of Conrail. They were: First, the potential transfer to a private person, in this case Norfolk Southern Corp., of tax benefits of Conrail that had been earned while Conrail was owned by the Federal Government and which were attributable to Federal Government funds; and second, the desire to assure the separation of the role of the Federal Government, specifically the Internal Revenue Service, as the administrator of the Federal tax system and the role of the Federal Government as the owner of the stock of Conrail to be sold to a private person.

In our discussions with the Department of Transportation and in our review of the Conrail transaction, we have paid particular attention to these two concerns. With respect to the treatment of Conrail's tax benefits, the Regional Rail Reorganization Act directed the Transportation Department to devise a plan for selling Conrail to the private sector, preferably through the sale of common stock rather than a sale of its assets.

As I am sure you are aware, under current law there are major tax differences between the sale of stock and the sale of assets, and those do affect the analysis of this transaction. In general, a purchaser of stock of a corporation receives a tax basis in that stock equal to the amount paid for the stock. Other than this change in the basis of the stock purchased upon the sale of stock, there are generally no tax consequences either to the purchaser of the corporation whose stock is sold—which we refer to as the target conporation. Accordingly, any tax attributes of the target corporation generally—there are some exceptions, but generally—remain intact, even though the target corporation is owned by different persons.

Conrail we understand has presently available a number of tax attributes of considerable potential value to a purchaser. They are principally net operating losses, investment tax credits, and the adjusted tax basis of its assets, including what is referred to as the frozen asset base.[1]

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[1] Under the Economic Recovery Tax Act of 1981, which replaced the replacement-retirement-betterment [RRB] method of depreciation the "frozen asset base"—which is the aggregate amount of expenditures that were capitalized under the RRB method of depreciation and whose cost was never recovered—may be recovered over a period of between 5 and 50 years under rates of depreciation provided by prior law.

If, under current law, the tax attributes of Conrail were allowed to carry over after the sale to Norfolk Southern, the availability of those benefits would presumably result in a somewhat higher selling price to the Federal Government of the Conrail stock. On the other hand, there would be a loss of revenue to the Federal Government caused by the utilization of those benefits. No net loss to the Federal Government would result if it received the exact value of those tax benefits, that is, if the future use of those benefits were accurately predicted and the proper discounted value was paid. But we know, and it is true in every corporate acquisition, that it is difficult to value those tax benefits because of the imprecision of that exercise.

On the other hand, because the sale of Conrail—stock was a statutorily preferred route—indeed so referred to in the legislation—it appeared appropriate to allow Conrail to be treated as if it were sold by a private party and allow it to carry over its historic tax attributes to the extent that those attributes were not attributable to moneys contributed by the Federal Government. That is, to try to place Conrail in the same position it would have been prior to the time that the Federal Government created Conrail, as if it were sold by a private person to another private person.

Because the net operating losses and the investment tax credits and certain other limited carryovers of Conrail are attributable to the period Conrail was owned by the Federal Government, and because they are very difficult to value, the Department of Transportation plan for the sale provides, appropriately in our judgment, that as a condition of sale Conrail and the Internal Revenue Service shall have entered into an agreement calling for Conrail's surrender of the net operating losses and the investment tax credits and other carryforwards as of the date of the sale, with the only condition being subject to their use against prior audit deficiencies if indeed any such deficiencies arise. And there are certain other very limited exceptions.

With respect to the tax basis of Conrail's assets, including the frozen asset base, after the sale to Norfolk Southern the Department of Transportation plan contemplates that the basis shall carry over. That is, it will be the same as it is in the hands of Conrail before the sale to Norfolk Southern under ordinary tax rules applicable to stock sales, with no difference here.

Now, we did review the data that was provided to us by the Department of Transportation and, based on that review, it would appear that the aggregate of the adjusted tax basis of Conrail's assets, including the frozen asset base, was approximately the same as of December 31, 1983, which is the last data we have available to us, as it was on the conveyance to Conrail, which was approximately April 1, 1976. Such amount as of April 1, 1976, was carried over to Conrail from its predecessor transferor railroads—I might add, consistent with the legislation that authorized those transfers—and was not attributable to Federal Government moneys. So that we are able, we think, to conclude on the basis of the data provided to us that the carryover of basis does not include adjusted tax basis attributable to funds that were contributed to Conrail by the Federal Government.

After Conrail was formed, Congress enacted special legislation to provide for the tax treatment of the transfer of assets to Conrail and, among other things, as I indicated, provided that neither Conrail nor any subsidiary would succeed to any net operating loss carryforwards, and that the basis of Conrail's assets received from the predecessor transferor railroads would carry over.

These same Federal tax consequences as reflected at the time of the creation of Conrail will be achieved by the Department of Transportation's plans for the sale of Conrail to Norfolk Southern, even though current law would provide more favorable treatment to Norfolk Southern and yield less tax revenue to the Federal Government.

Now I would like to make just a very brief comment on the efforts we went to to make sure of the separation of the Government's role as a tax administrator from its role as the seller in this transaction.

Let me say that the position we took, with which we had total cooperation from both the Department of Transportation and, I might say, in the later stages of the negotiation from Norfolk Southern Corp., was that no preferential or special rules would be adopted that would give this taxpayer some preference in the Internal Revenue Service's ability to deal with it as it would with any other taxpayer.

The plan for the sale of Conrail does not provide any restrictions on the Internal Revenue Service in auditing or assessing tax liabilities against Norfolk Southern Corp. or against Conrail after the sale to Norfolk Southern.

To the extent that the Norfolk Southern and the Department of Transportation negotiated in good faith, any protections against tax liability of Conrail or Norfolk Southern, which I might add are the kinds of issues that come up in every purchase and sale of a corporate enterprise to accomplish the objectives that purchasers and sellers seek, those protections are provided in the form of contractual warranties rather than covenants by the Internal Revenue Service.

And in that manner we believe we have kept the Internal Revenue Service separate and apart from this transaction, so that it can enforce its mission and evenly administer the Federal income tax laws.

There is certain legislation included in the proposal submitted by the Department of Transportation to implement a procedure for Norfolk Southern to enforce these tax warranties against the Federal Government if indeed enforcement of those warranties is required.

There is also certain legislation that will be required to qualify for tax purposes Conrail's employee stock ownership plan that was created by the earlier legislation. This legislation, which is included in the proposal submitted by the Department of Transportation, is necessary because of the unique form of Norfolk Southern's arrangement with Conrail's labor unions and employees and the unusual structure of Conrail's employee stock ownership plan.

Mr. Chairman, that concludes my prepared remarks. I would be happy to try to respond to your questions.

The **Chairman**. Mr. Pearlman, I may have some written questions for you, and I am sure other members of the committee may as well, on details of your testimony.

I would like to ask you for just a general conclusion. You are a tax lawyer. You have been in the private practice of law. I am sure you have represented all sides in various acquisitions in the past. Looking at this as a whole on the basis of your experience as a tax lawyer, do you have a view as to whether this is a fair arrangement?

Do you think that Norfolk Southern is buying some sort of tax windfall in this arrangement? Do you think that the Treasury is being ripped off? Do you think that it is a pretty fair arrangement for all parties?

Mr. **Pearlman**. Mr. Chairman, let me just say, I will be happy to try to answer any questions you do submit, or any other members of the committee.

My judgment is that these negotiations do indeed provide a very fair tax arrangement. It is always difficult, in representing either the purchaser or seller in a transaction, to try to evaluate the extent of tax benefits.

And we should not use the words "tax benefits" in a negative way. It should be the right of parties in a transaction to obtain the tax attributes of a corporation that are provided by law. So I do not mean to use that word in any pejorative way.

And it is always difficult, not only to establish the availability of those benefits, but also the value of those benefits. It was difficult in this transaction—and I am sure it was difficult for Secretary Dole and for the investment bankers to seek to value those benefits.

I think in my judgment that the Federal Government has benefited rather dramatically here by the fact that, rather than having to value, as private parties would have had to do, the net operating loss and investment tax credit carryforwards, that those were able to be dropped out of the transaction so that the margin of error, that could have flown either way but is more likely to fall to the disadvantage of the seller, will not fall to the disadvantage of the Federal Government.

On the other hand, I think the concept of permitting Conrail to carry forward an adjusted tax basis in assets that goes back to a period of time, that relates back to a period of time prior to the Federal Government's creation of Conrail is quite an appropriate way to adjust for this unusual environment in which we find Conrail.

So in my judgment this transaction was negotiated in a quite appropriate tax way and I feel very comfortable with the tax conclusions.

The **Chairman**. Senator Hollings.

Senator **Hollings**. Mr. Chairman, thank you.

Mr. Secretary, again, since there have been a couple of articles on this question, I will ask it in a different way. I think you have already covered it, but can you think of any tax benefits or windfalls that are being made available to Norfolk Southern under this proposal that otherwise would not be available?

Mr. **Pearlman.** No, Senator, I am not aware of any tax benefits or windfalls. I have noted the couple of narrow issues that have to be dealt with by legislation. I do not think anyone would characterize those as tax benefits or windfalls.

We have reviewed carefully and had input into the procedures that were established with the Internal Revenue Service to make sure that it was not giving to Conrail or to the Norfolk Southern Corp. anything that would not be appropriate to any other taxpayer.

We reviewed carefully and had input into the tax warranties that were given, that were negotiated between the Department of Transportation and Norfolk Southern Corp. I view those as quite appropriate, standard types of warranties.

So my judgment is there are indeed no windfalls being given to anyone on either side in this transaction.

Senator **Hollings.** Thank you, Mr. Chairman.

The **Chairman.** Senator Long.

Senator **Long.** No questions at this point.

The **Chairman.** Mr. Pearlman, thank you very much.

(The following information was subsequently received for the record:)

Department of the Treasury,
Washington, DC, March 27, 1985.

Hon. John C. Danforth,
Chairman, Subcommittee on Surface Transportation, Committee on Commerce, Science, and Transportation, U.S. Senate, Washington, DC.

Dear Mr. Chairman: This is in response to your request for our views of the Federal income tax policy issues raised by the proposed sale of the Federal government's interest in the Consolidated Rail Corporation ("Conrail") to Norfolk Southern Corporation ("Norfolk"). In preparing this response we have not comprehensively examined all potential Federal income tax consequences of the proposed sale, but have limited our analysis to certain issues of tax policy raised by the Federal government's ownership of Conrail and the form of the proposed transaction. In addition, our analysis has assumed that the details of the proposed transaction are accurately reflected in the Memorandum of Intent signed February 8, 1985 by Norfolk and the Department of Transporation, and in H.R. 1449 and S. 638, the pending legislation that would authorize and establish terms for the sale of Conrail.

We have previously consulted with the Department of Transportation with regard to its Congressionally mandated plan for the return of Conrail to the private sector. We thus have advised the Department of Transportation as to Federal income tax aspects of the sale of Conrail and have reviewed the tax implications of the bids for Conrail and of draft language for the Memorandum of Intent and enabling legislation. Our prior advice and the conclusions set forth in this response have been guided by two basic policy objectives: 1) that the sale of Conrail should not provide the purchaser with Federal income tax benefits that would not be available in an analogous transaction between private parties; and 2) that the Internal Revenue Service (the "IRS"), in its role as administrator of the Federal income tax laws, should not be prevented by the sales agreement or enabling legislation from treating Conrail in the same manner as it would any other taxpayer. Based on our analysis of the Memorandum of Intent and the enabling legislation, we believe that the proposed sale is basically consistent with these policy objectives.

BACKGROUND

Section 401 of the Regional Rail Reorganization Act of 1973 enacted by the Northeast Rail Service Act of 1981 directed the Department of Transportation to devise a plan for returning Conrail to the private sector, preferably by sale of common stock rather than by a sale of its assets. Under current law there are significant differences in the Federal income tax treatment of a sale of stock and a sale of the assets of a corporation. In general, a purchaser of the stock of a corporation receives a tax basis in the stock purchased equal in amount to the consideration paid for such stock. Other than this change in tax basis for the stock purchased, the sale of stock of a corporation generally does not trigger tax consequences either to the purchaser or to the corporation whose stock is sold. Accordingly, the existing tax attributes of the acquired corporation generally remain intact even though the corporation is owned by different persons.

CARRY OVER OF TAX ATTRIBUTES

Given the treatment of stock purchase transactions under current law, if the proposed sale of Conrail stock occurred between private parties the tax attributes of Conrail, such as its net operating loss carryforwards, investment tax credit carryforwards, and asset tax basis (including the so-called "frozen asset base"), would remain intact following the sale. The tax consequences of the proposed sale of Conrail to Norfolk would depart from this private transaction model in that certain of Conrail's tax attributes would not survive the sale transaction. Thus, pursuant to a closing agreement to be entered into between Conrail and the IRS, Conrail's net operating loss, investment tax credit and other carryforwards would, with certain exceptions, not be available for carryforward to taxable years beginning after the date of sale (hereinafter, the "Closing").[1] At the same time, other Conrail tax attributes, in particular, Conrail's asset basis, would, as in a private party transaction, carry over to taxable years after the Closing.

We believe the different treatment of Conrail's tax carryforwards on the one hand and its asset basis on the other is appropriate for a number of reasons. Conrail's existing carryforwards arose during the period of the Federal government's ownership and are for the most part attributable to monies invested in Conrail by the Federal government. The same is not true of Conrail's asset basis. Although the assets held by Conrail have changed substantially since its formation in 1976, data provided to us by the Department of Transportation indicates that the aggregate tax basis of its assets (as of December 31, 1983) is roughly equal to what it was at that time. Thus, the proposed transaction would return Conrail to the private sector with substantially the same asset basis as at the time the Federal government acquired it.[2]

We, of course, recognize that the purchase price in a sale transaction will reflect the extent to which advantageous tax attributes carry over in an acquisition. Where the Federal government is the seller, however, any gain in purchase price from a carry over of favorable tax attributes must be weighed against future revenue losses attributable to the purchaser's utilization of the tax attributes. This weighing is more difficult to the extent the purchaser's ability to use the attributes is uncertain. In this respect, the value of Conrail's carryforwards is inherently more speculative than the value of its asset basis, since the carryforwards would be of future value only to the extent that annual depreciation deductions generated by Conrail's asset basis had already been fully utilized. It would thus appear reasonable for the Federal government to require the termination of Conrail's carryforwards rather than speculate as to their value, while, in accord with the model of a private transaction, permitting Conrail to return to the private sector with its asset basis intact.

It should also be noted that the treatment of Conrail's tax attributes in the proposed sale is similar to what was approved by Congress at the time of Conrail's formation. Thus, legislation adopted in connection with Conrail's formation, now reflected in section 374(c) of the Internal Revenue Code (the "Code"), provided that the net operating loss carryforwards of Conrail's predecessors would not carry over to Conrail whereas Conrail would inherit its predecessors' asset basis. The tax consequences of the proposed sale of Conrail would generally conform to that legislative precedent.

Finally, the carry over of Conrail's asset basis should not cause a reduction in Federal income tax revenues collected from Conrail. Athough Conrail is a taxable entity, it has not previously paid Federal income tax, nor would it in the foreseeable future given its substantial carryforwards and the high basis in its assets. Because Conrail's carryforwards would not survive the proposed sale to Norfolk, the transaction would, if anything, accelerate the point at which Conrail would become a taxpaying corporation.

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[1] The closing agreement would also provide that Conrail's taxable year would terminate as of the Closing.

[2] If the effects of inflation are accounted for, Conrail's current asset basis is, of course, much less than at the time of its formation. Moreover, since the value of Conrail's assets today likely exceeds their value at the time of Conrail's formation, the built-in loss in its assets (i.e., the excess of their basis over value) is likely smaller today than it was at Conrail's formation.

UTILIZATION OF CONRAIL DEDUCTIONS BY NORFOLK

The proposed sale transaction could adversely affect Federal income tax revenues if future deductions generated by Conrail's asset basis could be utilized to offset otherwise taxable income of Norfolk. As an includible member in Norfolk's consolidated return, tax losses of Conrail could currently offset taxable income of any other member in the consolidated return unless such losses were limited under the separate return limitation year ("SRLY") and the built-in deduction rules of the consolidated return regualtions. These rules, in general, prevent the utilization of an acquired corporation's pre-acquisition losses (including losses attributable to assets with tax basis in excess of fair market value, so-called "built-in deductions") against income of any member of the acquiring group. It is conceivable that Norfolk would seek to avoid these restrictions through any of the following strategies: by satisfying the so-called de minimis exception to the SRLY and built-in deduction rules, by transferring assets to Conrail, the income from which would be absorbed by Conrail losses, or by merging Conrail into Norfolk (or an affiliated corporation) in a transaction in which Conrail's tax attributes would carry over.

The consolidated return regulations would provide an exception to the SRLY and built-in deduction rules, if, on the acquisition date, the aggregate of the adjusted tax basis of all assets of Conrail (other than cash, marketable securities, and goodwill) do not exceed the fair market value of such assets by more than 15 percent. See Treas. Reg. § 1.1502-15(a) (4) (i) (*b*). A review of Conrail's tax data, provided to us by the Department of Transportation, suggests that Conrail would not satisfy the deminimis exception, since its aggregate tax basis appears to exceed $3 billion, and Norfolk is paying only $1.2 billion for 85 percent of Conrail's common stock. The de minimis exception, however, is based on the fair market value of Conrail's assets rather than the value of Conrail's stock. Since we do not have appraisals or other direct information concerning the fair market value of Conrail's assets, it is not certain that Conrail would not satisfy the de minimis exception.[3]

Norfolk's ability to avoid the SRLY and built-in deduction rules by either transferring assets to Conrail or by merging Conrail into Norfolk or an affiliate would be constrained by Norfolk's contractual obligations, by practical business considerations and by the provisions of the tax law. Paragraph 12(b)(iii) of the Memorandum of Intent appears to prohibit a merger of Conrail into Norfolk (or an affiliated corporation) for at least five years after the Closing. In addition, it is questionable whether Norfolk would transfer significant income producing assets to Conrail given that, as reflected in Paragraph 12(b) of the Memorandum of Intent, there would be significant restrictions on Norfolk's ability to withdraw assets from Conrail. With regard to tax law limitations, a transfer of significant assets to Conrail or a merger of Conrail into Norfolk (or an affiliated corporation) could subject future use of Conrail deductions to challenge under section 269 of the Code. See Treas. Reg. § 1.269-3(b)(1).

WARRANTY OF ASSET BASIS

As provided in paragraph 6(e)(ii) of the Memorandum of Intent, the Federal government would warrant to Norfolk that the asset basis reflected on Conrail's tax return for the year ending on the Closing would not be decreased as a result of an audit adjustment for a taxable year ending on or before the Closing. We believe this warranty is appropriate for a variety of reasons. Most importantly, the warranty protection extended to Norfolk is consistent with the allocation of risks that could be expected in an analogous private party transaction. Conrail has not been audited since its formation and its tax basis in many assets would have to be traced to its predecessors. As a consequence, Norfolk has no effective means of determining whether Conrail's asset basis is accurately reflected on its tax returns. In circumstances where the accuracy of the selling party's tax accounting cannot be established, it is reasonable to expect the seller to retain the risk of audit.

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[3] Paragraph 12(e) of the Memorandum of Intent provides that as a condition to Norfolk buying Conrail from the Federal government, Norfolk shall have received (at the Federal government's sole election) either a ruling or a warranty that amounts paid to employees of Conrail for services rendered after Closing in order to increase their post-Closing wages to industry standard and the costs paid or incurred for certain routing concessions which are otherwise ordinary and necessary business expenses shall not be treated as built-in deductions and can be deducted when accrued or paid. Although the SRLY and built-in deduction rules apply to amounts economically accured but not yet deducted, the above expenses do not appear to consitute built-in deductions. Because of the condition that such expenses must otherwise be ordinary and necessary business expenses, the ruling or warranty required by the above condition does not warrant the deductibility of such amounts; only that such amounts are not built-in deductions.

Consistent with the above warranty, Paragraph 6(e) (iii) and (iv) of the Memorandum of Intent require the Federal government to warrant that the adjusted tax basis of Conrail's assets would not be reduced and no gain or loss or income would be recognized by Conrail or Norfolk as a result of the sale of Conrail's stock to Norfolk, except in the event Norfolk makes, or is deemed to have made, an election under section 338 of the Code. If a section 338 election were made (or deemed made) by Norfolk in connection with its purchase of the stock of Conrail, Conrail would be treated as if it sold all of its assets to itself in a liquidating sale, and the tax basis of its assets would be adjusted to an amount based upon the amount Norfolk paid for Conrail's stock (grossed-up to reflect a purchase of 100 percent of Conrail's stock). The Memorandum of Intent further provides that, for purposes of the warranty, Norfolk would not be deemed to make a section 338 election as a result of any asset acquisition provided that Norfolk (and its affiliates) elect either to treat such assets acquired in accordance with regulations promulgated under section 338 or elect under conditions to be agreed upon that the basis of such assets would not exceed the transferor's basis in the assets immediately before the acquisition. This warranty was provided because, as of the date the Memorandum of Intent was signed, the regulations providing for a carryover basis to avoid a deemed election under section 338, contemplated by Congress in the Tax Reform Act of 1984, had not been issued.

It should be noted that the warranty protection that Norfolk receives is not a guarantee that the IRS will not audit Conrail for pre-Closing years or that if it does so that it will not be entitled to require a reduction in Conrail's asset basis. In the event of an IRS audit and resultant reduction in basis, the warranty procedure contemplated in the Memorandum of Intent and enabling legislation entitles Conrail to sue in Federal court and to obtain a judgment which could be applied to offset any increase in tax liability attributable to the basis reduction. Although this procedure leaves Conrail economically protected from the risk of audit, it does not otherwise impair the IRS' ability to conduct an audit of Conrail. Retention of the IRS' audit authority with respect to Conrail's pre-Closing years could be significant to the extent substantive tax issues relating to those years have relevance to issues arising in other tax years of Conrail or to the administration of the Federal income tax system generally.

CHANGE IN METHODS OF DEPRECIATION

The potential value of any built-in loss in Conrail's assets also depends on the period of time over which those assets would be depreciated. The warranty as to asset basis provided in Paragraph 6(e)(ii) of the Memorandum of Intent contains a condition that the depreciation of such assets should be determined without extraordinary departures from the methods of prior years. In general, since a depreciation method is considered a method of accounting, a taxpayer cannot change its method of depreciation with respect to a particular asset without first obtaining permission from the Commissioner of the IRS.[4] In this regard, Conrail and Norfolk would be treated the same as any other taxpayer if, after the sale of Conrail, a change in depreciation method were requested.

CARRY OVER OF EARNINGS AND PROFITS

At present, Conrail may have a deficit earnings and profit account reflecting its substantial net losses over the period of its operation.[5] The Memorandum of Intent does not directly state whether the earnings and profits history of Conrail would carry over to post-Closing taxable years. Since earnings and profits ordinarily would carry over in a stock acquisition, the failure to state a contrary result suggests that Conrail's earnings and profits account would survive the transaction. Since earnings and profits are a measure of a corporation's income or loss, it would seem that Conrail's earnings and profits should be treated consistently with Conrail's net operating losses, and thus should not carry over to post-Closing years. We thus believe that a definitive sale agreement should clarify the treatment of Conrail's earnings and profits by providing that they not carry over in the sale transaction.

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[4] Section 203(c) of the Economic Recovery Tax Act of 1981 permitted taxpayers to change their method of depreciating railroad track without having such change treated as a change in method of accounting. It does not appear that this provision applies to a change in the method of depreciating railroad track initiated after 1981. Thus, Conrail should not be able to change its present method of depreciating its "frozen asset base" without securing the prior approval of the IRS.

[5] We have not been provided any data on Conrail's earnings and profits. There may be uncertainty as to the exact amount because of the uncertain effects of prior law.

The value to Norfolk of a carryover of Conrail's earnings and profits in uncertain. Earnings and profits determine the extent to which a corporation's distributions to its shareholders are dividends rather than a return of capital. Although a deficit earnings and profits account would permit a corporation to make nontaxable return of capital distributions to its shareholders,[6] Conrail will be a wholly-owned member of Norfolk's consolidated group and thus its distributions will be nontaxable whether characterized as dividends or as a return of capital. We understand that Norfolk itself has a substantial surplus in its earnings and profits, and thus any distributions by Norfolk to its shareholders would be fully taxable dividends even if they were attributable to distributions from Conrail. Moreover, Norfolk's surplus in earnings and profits would not be offset by any deficit of Conrail even if Conrail were to merge with Norfolk. See section 381(c)(2) of the Code.

CANCELLATION OF CONRAIL DEBT AND PREFERRED STOCK

The Northeast Rail Service Act, which directed the Department of Transportation to devise a plan for the sale of Conrail, also directed that Conrail be sold free of the Federal government's existing debt or preferred stock interests. The apparent intent of the legislation was that Conrail be returned to the private sector with a sound capital structure. This intention is reflected in Paragraph 3 of the Memorandum of Intent, which provides that prior to the sale, approximately $850 million of outstanding Conrail debt, including accrued interest thereon, and approximately $2.3 billion par value of Conrail preferred stock, including accrued and unpaid dividends thereon, held by the Federal government would be "cancelled or retired, and contributed to the capital of Conrail." In addition, under Paragraph 6(e)(i) of the Memorandum of Intent, the Federal government would warrant that Conrail will not recognize income on account of the cancellation of Conrail preferred stock or debt.

Under general tax law principles, reflected in section 61(a)(12) of the Code, a corporation may recognize income where it retires outstanding indebtedness at a cost that is less than the face amount of the indebtedness. This discharge of indebtedness principle recognizes that a taxpayer has an economic profit where it borrows money which it is not required to repay in full. Certain exceptions to the discharge of indebtedness principle are enumerated in section 108 of the Code, including that a corporation does not recognize income where a shareholder contributes indebtedness to the corporation's capital (provided that the shareholder's basis in the debt is not less than the face amount of the debt). This exception, stated in section 108(e)(6), effectively recognizes that any excess of the amount borrowed from a shareholder over the amount repaid might have been directly contributed to the corporation without causing the corporation to recognize income.

Under the substantive principles described above, Conrail would not recognize income from the cancellation of its debt if such cancellation were treated as a contribution to its capital by the Federal government. Although there is little authority addressing whether a shareholder's cancellation of corporate debt is a contribution to capital, characterization of the cancellation of Conrail's debt as a contribution to its capital would seem probable. The cancellation of Conrail's debt would be structured in this form, the cancellation was directed by Congress, and the practical effect of the cancellation would simply be to enhance the value of Conrail common stock owned or controlled by the Federal government.[7]

Even if the cancellation of Conrail's debt were not treated as a contribution to its capital by the Federal government, Conrail's carryforwards would remain available to offset any discharge of indebtedness income to Conrail for a preclosing year. Given the size of Conrail's carryforwards in comparison to the amount of its outstanding debt, the warranty that Conrail would not recognize discharge income offers additional protection to Conrail only to the extent such income might be recognized after the Closing, i.e., in a year in which the carryforwards would not be available to absorb the income. Although it may be conceivable that the debt cancellation and sale of Conrail could be recharacterized so as to cause Conrail to recognize discharge of indebtedness income after the Closing, any such income would as a practical matter be attributable to the period in which Conrail was owned by the Federal government. We thus believe it is consistent with the other tax consequences of the proposed sale that Conrail be held harmless from any tax liability arising from the cancellation of its indebtedness. A warranty providing for this result is additionally appropriate given that the cancellation is directed by legislation.

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[6] A carryover of any Conrail deficit in earnings and profits could well be disadvantageous to Norfolk, since it would limit Conrail's ability to issue new preferred stock to outside interests. The market for such preferred stock is predominantly among corporations, for whom dividend distributions are more advantageous than returns of capital.

[7] The Federal government owns approximately 85 percent of the common stock of Conrail, with the remaining 15 percent being held by Conrail Equity Corporation ("CEC"), a subsidiary of Conrail (see discussion below under Transactions Involving Conrail's ESOP).

The proposed sale agreement also warrants that Conrail will not recognize income from the cancellation of its outstanding preferred stock. Under general tax law principles, a corporation does not recognize income upon a reacquisition of cancellation of its own stock. Thus, absent a recharacterization of the transaction, Conrail should not recognize income from the cancellation of its preferred stock.

Although we are uncertain as to why this warranty was requested, it might conceivably be out of a concern that Conrail's preferred stock could be characterized for tax purposes as indebtedness, and thus that Conrail may recognize income from its cancellation. There is little authority indicating under what circumstances an investment denominated as preferred stock could be recharacterized as debt for tax purposes. We nevertheless view the possibility of such recharacterization in Conrail's circumstances as remote. Recharacterization of any substantial portion of Conrail's preferred stock as debt could push Conrail near or into insolvency.

TRANSACTIONS INVOLVING CONRAIL'S ESOP

Approximatley 15 percent of Conrail's common stock is beneficially owned by Conrail's employee stock ownership plan ("ESOP").[8] Paragraph 2 of the Memorandum of Intent provides that, at or prior to the Closing, Norfolk or Conrail shall have made appropriate arrangements with respect to the employees of Conrail to accomplish the acquisition by Norfolk of such employees' 15 percent beneficial interest in Conrail. While we understand that separate negotiations between Norfolk and Conrail's employees are still pending, Exhibit A to the Memorandum of Intent indicates that Norfolk proposes to transfer $375 million in cash or Norfolk common stock to Conrail's ESOP.

To the extent that Norfolk's transfer to Conrail's ESOP is in exchange for the ESOP's beneficial interest in Conrail's stock, such amounts would not be deductible contributions by Norfolk but rather costs incurred in acquiring Conrail's stock. On the other hand, to the extent that the amount of Norfolk's transfer to Conrail's ESOP exceeds the value of the ESOP's beneficial interest in Conrail's stock, such amount could be a deductible contribution by Norfolk, subject to the deduction timing rules of Code section 404 (including section 404(j)) and the continued qualification of Conrail's ESOP. The enabling legislation specifically provides that no inference is to be drawn from the provisions of that legislation regarding either the allocation of Norfolk's $375 million transfer between the purchase of Conrail's stock and deductible contributions to the ESOP or the deductibility of any portion of such transfer by Norfolk to Conrail's ESOP.[9]

If the form of Norfolk's arrangements with Conrail's employees were to cause disqualification of Conrail's ESOP, such employees generally would be currently taxable on the value of their beneficial interest in the trust. In this regard, section 132 of the enabling legislation provides that Conrail's ESOP and related trusts maintained, amended, or adopted in implementing the Secretary of Transportation's plan for the sale of Conrail shall be deemed to meet the qualification requirements of section 401 and 501, notwithstanding that such plans may not meet the requirements of Code section 415 (which relate to limitations on contributions and other additions with respect to participants in a qualified plan) or that participants in such plans may be entitled to withdraw a portion of the shares allocated to their accounts prior to the expiration of the two-year period generally imposed by the IRS for qualified plans (see Treas. Regs. § 1.40-1(b)(1)(ii)). Although Norfolk's arrangements with Conrail's employees have not been finalized, we believe it appropriate, given the possibly unique form of such arrangements and the unusual structure of Conrail's ESOP, to waive by legislation these two possible technical violations in order that Conrail's ESOP maintain its qualification.

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[8] CEC, all of the common stock and approximately 50 percent of the preferred stock of which is owned by Conrail, currently owns approximately 15 percent of the common stock of Conrail. The other 50 percent of CEC's preferred stock is owned by Conrail's ESOP. Under existing agreements, Conrail's ESOP by 1991 would own 100 percent of CEC's preferred stock which would then be exchanged for the 15 percent of Conrail's common stock held by CEC.

[9] It should be noted that under Paragraph 12(b)(viii) of the Memorandum of Intent Norfolk and Conrail are prohibited for at least five years from obtaining a reversion of any excess assets held in connection with Conrail's Supplemental Pension Plan. A reversion of plan assets to either Norfolk or Conrail would not be permissible unless and until the plan is terminated and all liabilities of the plan to the employees are fully satisfied.

Sincerely,

RONALD A. PEARLMAN,
Assistant Secretary (Tax Policy).

The CHAIRMAN. Our final witness today is Mr. Robert Claytor, chairman and chief executive officer, Norfolk Southern Corp. Mr. Claytor, thank you for being with us.

STATEMENT OF ROBERT B. CLAYTOR, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, NORFOLK SOUTHERN CORP., ACCOMPANIED BY JOHN TORBYFILL, EXECUTIVE VICE PRESIDENT—FINANCE; HAROLD HALL, PRESIDENT AND CHIEF OPERATING OFFICER; AND HENRY WATTS, VICE PRESIDENT OF CORPORATE DEVELOPMENT

Mr. CLAYTOR. Thank you, Mr. Chairman. Mr. Chairman and honorable members of the Senate Committee on Commerce, Science, and Transportation:

I am Robert B. Claytor, chairman and chief executive officer of Norfolk Southern Corp. Joining me at the table today are three of my fellow officers. On my left and your right is Harold Hall, our president and chief operating officer. On my right first is John Torbyfill, who is our executive vice president in charge of finance. And on our far, far right is Mr. Henry Watts, who is our vice president of corporate development. I am getting old, do not even know my own people.

Mr. Chairman, I welcome this opportunity to testify before this committee in support of Secretary Dole's acceptance of Norfolk Southern's offer to acquire the Government's 85 percent stock interest in Conrail. At the conclusion of this testimony, we will file—I believe it already has been filed—a full copy of my prepared testimony, and of course I will be glad to answer any questions the committee might have at the conclusion of these remarks.

First let me briefly refresh your recollection about our company. Norfolk Southern Corp. was formed in 1982 as a holding company to own and control two of America's finest rail carriers, Norfolk & Western Railway Co. and Southern Railway Co.

Our two railroads are operated from their own headquarters, the Norfolk & Western in Roanoke, VA, and Southern Railway Co., in Atlanta, GA. If Conrail were added to our system, as I certainly hope will be the case, it would be added as a third, full partner to Norfolk & Western and Southern, and would continue to be operated from its own headquarters in Philadelphia, PA, as it is today.

Now, Norfolk Southern is a strong and financially sound company, with assets in excess of $8 billion and with more than $1 billion in cash and temporary short-term investments. We have a favorable debt-equity ratio and in 1984 had net income of $482.2 million. And we pay substantial taxes. Not that I brag about it, but it is a fact. Our pretax net income last year was $839.2 million. We incurred current taxes of over $177 million and deferred taxes of almost $180 million.

Norfolk Southern's lines extend over some 20 States in the Southeast and Midwestern sections of our country, with about

18,000 miles of road. Our chief rail competitor, as you all probably know, is the CSX System, which covers almost all of the same territory we serve, but in addition has lines extending into the Northeastern section of the United States, which we do not serve.

One of the primary purposes of this proposed acquisition of Conrail and one of the plain public benefits from such an acquisition is that it will enable the Norfolk Southern to be competitive with the CSX System throughout the Northeastern territory. At present, Norfolk Southern's lines do not extend north of Washington or east of Pittsburgh and Buffalo. Our proposal plainly would increase competition in that important section of the country.

Mr. Chairman, the prepared testimony which I filed with the committee makes three principal points, which I would like to summarize briefly for you now. They are:

First, Norfolk Southern will pay a full and a fair price for Conrail, arrived at through open competitive bidding. The chart on my right summarizes for you the major, although by no means, by no means, all of the components of the Norfolk Southern's financial commitment.

As you can see, we propose to pay the Government $1.2 billion in cash for its 85-percent stock interest, plus any surplus cash which Conrail might have on the day of closing. This is set forth in our memorandum of intent which Mrs. Dole and I signed earlier this month.

The real price which we are paying for the Government's equity interest is actually far more than the $1.2 billion in cash we will lay on the table on the closing day of this sale; $375 million would be paid to Conrail employees to acquire their 15 percent ownership of Conrail securities and for whatever interest and claims they might otherwise have against Conrail as a result of wage deferrals prior to July 1984.

In addition, Norfolk Southern would give up important tax benefits, including, as the chart shows, $2.1 billion in operating loss carry-forwards, which can be valued at over 40 cents on the dollar, and $275 million in investment tax credits, which can be valued dollar for dollar.

Although the chart does not show it, we could add $30 million a year, based on 1984 tax rates, as a result of our commitment to resume local and State tax payments, which Conrail does not now pay.

The chart also shows a number of guarantees and commitments, which are difficult to value in dollars and cents, but which do have a direct economic cost to Norfolk Southern as a purchaser and which promote the public interest by ensuring continuation of Conrail's service and enhancing competition in the Northeast and Midwest. As you can see, they include the guarantee that we will continue for a minimum period of 5 years all economically justified Conrail freight services, that any abandonments will be governed by full ICC procedures and not the expedited method which Conrail is presently allowed to use.

Additionally, we are guaranteeing that for the next 5 years Conrail will make a minimum investment of $350 million to $500 million annually in its properties, and that we will permit no deferred maintenance contrary to our own standards during that period. I might add that Norfolk Southern prides itself in having what in our opinion is the very best maintained rail system in the country, and we intend to see that Conrail adheres to these same standards.

Next, we have agreed to refrain from drawing down dividends from Conrail, except to the extent of 40 percent of Conrail's net income after closing, and then only if a minimum cash balance of $500 million would remain. We have also agreed to divest over 1,000 miles of lines—actually, it is in excess of 1,200 now—to a competing carrier or carriers in accordance with the Department of Justice requirements.

Finally, from the last item on the chart, you will see that we have agreed that we will reopen cost competitive Conrail routes to smaller Eastern rail carriers where such carriers believe that the routes are critical. Now, this is an important, a very important procompetitive commitment which many people have overlooked. The regional lines rely heavily on connections to participate in routings, and for them a less restrictive routing policy will aid continued rail service in the region.

Now, the second point I want to make is that Conrail standing alone is the only major regional railroad left in this Nation, and as such it faces heavy risks and an uncertain future.

Unless checked, its continuing drop in traffic in recent years, together with heavy capital expenditures which will be required in the near future, spell financial trouble and raise the distinct possibility that, if cast adrift on its own, history will repeat itself and Conrail will become another Penn Central. I am certain that Congress does not want that scenario.

The chart also illustrates this point. As you can see, the business of Conrail and its predecessors show a continuing decline. Now, in all candor, Mr. Chairman, the trend on this graph is dangerous for Conrail, it is dangerous for Norfolk Southern, and it is dangerous for the private rail sector in the Northeast. Certainly Conrail should not be left to sink or swim in this environment.

Norfolk Southern brings great strength to Conrail. But even more importantly, it offers real opportunity in the long run to flatten out this line, or hopefully to turn it upwards.

Now, the final point I want to make relates to market enhancement and competition. The point here is that we can increase Conrail's business and employment by becoming more competitive, both with the motor carriers and with the CSX rail system.

At such important points as Baltimore and Philadelphia, CSX has a major competitive advantage on traffic moving to the South, since Conrail is not interested in this short haul business and since Norfolk Southern lines do not penetrate the area. Putting Norfolk Southern, through Conrail, into Philadelphia and Baltimore, for instance, would enable us to compete head to head with the CSX system.

They do not like that prospect, and they have raised a number of problems, principally the bugaboo of antitrust. And the problem is not antitrust, Mr. Chairman. The problem is they are just afraid of competition.

The final chart, which is up now, gives you a better idea of why our friends at CSX are so upset about our proposal. Well, right now, Mr. Chairman, they are the queen bee. The columns on the left, headed "pre-acquisition," show, for instance, that in terms of miles of road CSX is 143 percent of Norfolk Southern. In merchandise business, which is the heart of Conrail's business, CSX is 171 percent of Norfolk Southern. All of the figures show that at the present time the CSX is dominant, and obviously the CSX wants to stay that way.

Now, let us take a look at the postacquisition numbers. Now, you will see that the situation is somewhat changed. But you will also see that it by no means has completely reversed. Norfolk Southern and Conrail would have about 25 percent more miles of road than CSX. We would still not originate as many tons of traffic. CSX would continue to have an advantage in coal and in the number of ports which it serves.

I am afraid I just have to conclude that CSX's opposition is based on perceived self-interest, which unfortunately it attempts to equate with the public interest.

Now, time does not permit me to go into one other point, which is the divestiture of lines which we have worked out to comply with the Department of Justice conditions. Suffice it to say that we have agreed to dispose of over 1,200 miles of lines, plus some additional trackage rights, to furnish competitive service.

Now, while I do not personally agree that this is necessary—in most parts of the country two railroads are the norm—in many places just one, but two is considered ample. But here we have gone along with the Department of Justice's position and have preserved the same number of railroads, basically three or more. We have acceded to their position.

Mr. Chairman, if you or the committee have any questions we will attempt to handle them.

The CHAIRMAN. Thank you very much, Mr. Claytor.

Can we sell you Amtrak as well?

Mr. CLAYTOR. Mr. Chairman, I would have to consult my brother about that.

The CHAIRMAN. The agreement that has been reached between the Department of Transportation and Norfolk Southern contains certain covenants which last for 5 years, and one question is, well, 5 years is wonderful, but how about after that?

We are going to be faced in 5 years with the whole question of rail transportation in the United States. Can we be relieved of any concerns that we are not going to be back in the soup in 5 years? Does Norfolk Southern intend to conduct Conrail on a good, strong basis in perpetuity?

Mr. CLAYTOR. Well, I hope we certainly can conduct it in perpetuity. That is a long time, Mr. Chairman.

But let me say this. Five years is the period it will take us to bring Conrail into our system as a full partner, because we want to do it gradually. We do not want to have any disruptions of service. We do not want to have disruptions of people any more than is necessary. In this 5-year period, we are perfectly agreeable to the protections and the covenants which we have set forth.

I think the 5 years is a sufficient time to ensure that Conrail is incorporated fully into our system as a full partner, and that at the end of that time Conrail will be exactly as Norfolk & Western and

Southern, and that, in effect, if we cannot swim together, we will all sink together.

And if Norfolk Southern sinks, believe me, the whole railroad industry in the United States is headed for nationalization, something I do not predict, do not want, and I think this is a major step toward preventing that from happening.

So I think 5 years is a sufficient time. At the end of that time, these covenants will be not necessary in order to preserve Conrail's service.

The CHAIRMAN. Looking down the road, does the management of Norfolk Southern anticipate any major changes after 5 years in the operation of what is now Conrail?

Mr. CLAYTOR. Well, Mr. Chairman, I have learned not to predict what my successors are going to do and what efficiencies or changes they would make. If the competition changes in 5 years, if businesses move, Conrail, either alone or as part of our system, will have to make necessary changes to react to changed business conditions.

But I do not foresee—and I certainly hope that we will be able, by being more competitive, by being more efficient, by being better railroaders, because when we put the two railroads together we have found what we can do in improving railroading, we will be able to get enough business back on the rails, much of which is presently moving over the highways in the Northeast, to keep Conrail not only as it is today, but as a stronger company than it is.

Today two-thirds of the business in the merchandise business in the Northeast is on the highways. Much of that business does not belong on the highways, Mr. Chairman. It belongs on the rails, and one of the reasons it is not on the rails is that we are not able to get into that area and to compete.

We bring lots of traffic from the South, from Louisiana, from Georgia, from South Carolina, and we carry it north to Potomac Yard across the river here. And because we really do not go any further north, we have no alternative but, in the case of piggyback business, to put the trailers on the highway and haul them up into Philadelphia and to Pennsylvania.

This is the business—some of the business we hope to put back on the rails, where it belongs, not on the 14th Street Bridge.

The CHAIRMAN. Do you think that the employees of Conrail and of Norfolk Southern should be concerned about this arrangement?

Mr. CLAYTOR. I think they should support it, Mr. Chairman. Let me say this first. Employment in the rail industry has been declining, as the committee well knows, and drastically. The basic reason for the decline is business. In the long run, the employment on Conrail, whether we own it or whether it is continued to be owned by the Government or whatever, is going to depend on the level of business, on how much traffic we can generate.

Our proposal is the only one which offers an opportunity to increase business for Conrail. We can see higher business levels or we would not be in here, because the traffic trend in the Northeast is down. The smokestack industries are declining still.

But if we cannot turn this around, we are going to be in trouble, too. We hope and believe we can, sir. But we think that our proposition is in the best interest of the employees.

Now, we have already been open and candid—and that is our style, Mr. Chairman—about what we are proposing to do in the way of coordination of facilities with Conrail and the jobs which would be affected. We have said that, in our initial proposition for inclusion of Conrail in our system, it would cost about 1,250 jobs as a result of added efficiencies.

Now, you can cut that in half, you can cut that about in half, I believe—2,530, I am sorry. I have got the miles of line. I have got that mixed up with the miles of line. It is 2,530 jobs would be adversely affected.

Now, we can cut that in half or more if we divest our lines, as we propose to, to Guilford Industries and Pittsburgh & Lake Erie. Now, those employees will be protected if they are adversely affected, those that are left would be. Anyone who is adversely affected in his job will be protected by up to 6 years pay, which is a very generous protection.

In addition—and it has not been brought out, I believe, at the hearing yet—we have said to our labor friends that we know that the next 2 or 3 years are going to be very difficult for you and your people, and we want to gain your confidence. Mr. Chairman, we do not want to take over a demoralized railroad, whose employees are frightened for their future, who are afraid they are going to lose their jobs because we are going to bring in more efficiencies.

We want to bring a real team, a real Conrail team, including its management, into our system. And one of the ways we are going to do that is we are going to say that, for the next 3 years anybody who loses his job as a result of an added efficiency will be given a year's pay. We think that is very fair and it is certainly beyond anything that we are required to do.

So I think, to answer your question in a long way, we really believe that railway labor is going to benefit in the long run by our proposition and will have greater job security for all of our people.

The CHAIRMAN. Senator Hollings.

Senator HOLLINGS. The Secretary, Mr. Claytor, attested to the fact that she had several, 15 or so good offers, which she narrowed to 6 and then down to 3. I take it that during that course you were sweetening the offer, weren't you? Or did you make a bottom line offer?

Mr. CLAYTOR. I have to go back and try my recollection on this, Senator Hollings.

Senator HOLLINGS. Well, looking out for the public, why should I not just wait 6 months and get you to sweeten your offer some more?

Mr. CLAYTOR. No, sir, I do not think we will sweeten it any more.

Senator HOLLINGS. Why not?

Mr. CLAYTOR. We have bid the top dollar, Senator Hollings. We have bid a full price and as much as we can justify to our stockholders.

Now let me say this. Originally, as I recall, the bids—we had to decide on a bid and it was a difficult proposition. We made studies and we made projections. And just going back in my recollection, I recall having a long discussion with Mr. Torbyfill here, our chief financial officer, about what we ought to bid.

And he said about the best he could come up with at that time was $900 million. At that time there was talk that that would not do it. And I think I took the responsibility of saying: Well, we can find some more savings and efficiencies somewhere; let us bid a billion. And we bid a billion, and I think that was basically the same as a couple of other bids that came in.

After that we had long discussions with the Department of Transportation, and the Secretary told us in effect that that was not enough, that if we wanted to stay in this game it had to be at least $1.2 billion. After some soul-searching and some analysis and some decision that we would take more risks with our company, with our money, than we had really wanted to, we increased it to $1.2 billion for the Government's share. Of course, that does not include the 15 percent which the employees have a right to, and that is handled separately.

And that is the final bid we put in. I would think in 6 months—I know in 6 months we would not be in a position to increase this in any way.

And if this were to go to a public offering, Senator Hollings, and if it came in, as I am sure it would, less than we have bid, I would have to say first that the marketplace has set the price and I think we would probably have to reconsider. There is no use us paying more than the market would think it would be worth.

I think the risks on postponement are all on the down side.

Senator HOLLINGS. Is there any terminal date? What is the contract with the Government at the present time, the agreement between you and Secretary Dole? Is this to be consummated in a specific time period?

Mr. CLAYTOR. It would have to be completed by the end of this year, under the memorandum of intent.

Senator HOLLINGS. I see. And looking at the railroad business generally speaking, where is the fire? Conrail made $500 million last year, Congress is not going out of business, Conrail is not going out of business, and Norfolk Southern is not going out of business.

Why not give it a try? Why not have a public offering and come in here next February and see what we can do? What is the taxpayer loss there?

Mr. CLAYTOR. Let me say a couple of things about that, Senator. If we put it off until next year, I think first we would have to reconsider whether we want to be involved any further.

I have a problem in running what is a good company, well-run company, but our management team is not big enough so that we can spend 2 or 3 years with total involvement in a transaction of this kind. We simply have to get on to something else, and if we are not going to get with Conrail I think we have to look elsewhere, wherever it may be.

But second and perhaps more important, Senator Hollings, I think that would be terribly unfair to the people on Conrail and to its loyal employees and to its able management. I have been through mergers. I have been through mergers with the Virginia Railway, I have been through mergers with the Nickel Plate & Wabash, I have been through the recent consolidation with the Southern. I know something about the uncertainties and the problems that employees and management face, that they face when they are confronted with change of the nature involved in a major consolidation.

To keep it on the string and keep it undecided for another year or two, while people do not know what is coming and scare tactics are everywhere, I think is basically unfair to the people who are most involved, that is, the people in Conrail and the people on Norfolk & Western, Norfolk Southern.

Senator **HOLLINGS**. Norfolk Southern, Norfolk & Western.

Mr. **CLAYTOR**. Well, the Norfolk & Western part of our Norfolk Southern, sir, is the part which is basically involved in the consolidation. And I have to say that the employees on Norfolk & Western are, in some of the areas, are some of the ones which stand to have some job curtailment, perhaps even more than the Conrail employees in those areas. So naturally they are concerned, too.

Senator **HOLLINGS**. Perhaps this could be an unfair question, and you can disregard it. With respect to our good management over there at Conrail, Mr. Stanley Crane, he seems to be fighting a rear guard action. Now, he formerly ran your railroad and in fact I think maybe recommended you for the position you have right now.

Mr. **CLAYTOR**. No, sir, he did not.

Senator **HOLLINGS**. Well, you have answered my question. I was beginning to wonder what was wrong. Thank you, Mr. Chairman.

Is there something the committee ought to know about that? You fellows are fighting in this railroad business, which I enjoy, to tell you the truth.

Mr. **CLAYTOR**. This seems to be a subject of some public interest. We want to take over the Conrail management as intact as possible. I have said many times that I would not be interested in Conrail as a piece of asset, as a barebones railroad with nobody to run it.

The management of a company and the management of a railroad are important assets. We want the management of Conrail as intact as possible, and I include in that Mr. Crane.

Mr. Crane, for reasons involving his age, would have to be given an important consulting role, but nevertheless he could remain as part of the team, and I think any intimation to the contrary by anyone is wrong.

Senator **HOLLINGS**. Thank you, Mr. Claytor.

The **CHAIRMAN**. Senator Long.

Senator **LONG**. I just have a few questions here that I want to submit. You can give us the answers.

Mr. **CLAYTOR**. Senator Hollings, Mr. Hall wanted me to make the point that Mr. Crane was President of the Southern Railway, not my railroad, which was N&W. And his successor was Mr. Hall, and so he had no opportunity to recommend me, for or against.

The **CHAIRMAN**. Senator Rockefeller.

Senator **ROCKEFELLER**. Thank you, Mr. Chairman.

Mr. Claytor, you indicated—and I will ask the same question to CSX when they appear before us. But you indicated that CSX was afraid to meet the competition. Thus this question of loss of jobs or competition for jobs, potential loss of jobs, in the B&O sector.

It seems to me that we have here two types of jobs at stake. One is the immediate, which is what happens when there's competition between two giant railroad systems and one prevails in a particular region of the country or of the State over another because of being able to get a hold of the market through lower prices or whatever.

And second is, assuming the first, where one railroad proceeds to underbid another in terms of rail rates, which for the coal industry, as in the case of West Virginia and Appalachia, is a benefit, because what we have been fighting, as you very well know, sir, through the market dominance situation is not an abundance of competition, but a lack of competition which allows individual railroads to set what it is that they choose to charge for the movement of coal from the point of origin to the point of sale.

Now, if as you suggest CSX would be afraid to meet the competition in terms of—I would have to presume you are talking about rail rates competition——

Mr. CLAYTOR. Rates and service, Senator.

Senator ROCKEFELLER. Yes. Are you suggesting that it is more likely that this would strengthen your position so that you would be able to in fact do a rate reduction procedure with respect to coal in that part of the northern part of our State?

Mr. CLAYTOR. Well, Senator, let me say a couple of things. I think there is plenty of competition for coal, and you would have to analyze each market to answer your question directly on the amount of competition that railroads presently face.

However, as far as this particular situation is concerned, I cannot see anything but a positive effect as far as the coal market is concerned. In the first place, it gives us a single line haul from your State to points in the Northeast that we presently do not have.

We presently have to transload, transfer the cars from one railroad to another, at Hagerstown, MD, for instance, or Potomac Yard, and that involves costs and that involves inefficiency, and that involves the question of whether CSX on the other side is willing to make a connecting rate, in effect.

Now, if we are able to do this with our own railroad from origin mine to destination, say powerplant, we have an advantage that CSX presently has to that area. We are given an equality of competitive opportunity. And in addition, the inclusion of Conrail in the Norfolk Southern, as we have already indicated, will produce efficiencies.

Now, in the long run all rates have to be based on costs, because if you do not you are going to go out of business. And if we become more efficient, as I hope we would, in the movement of all-rail coal to the Northeast, we will be in a position to give lower rates to our customers up there, to the customers we hope to get, and I think the public will benefit.

Senator ROCKEFELLER. It has been my experience, Mr. Claytor, that when two large groups join together for the purpose of moving coal in the Mid-Atlantic region, West Virginia usually comes out on the short end of the stick. And it was for that reason that I for one strongly opposed the merger of CSX and the American Barge Co.

There were relatively few Governors who did that. But I sought the prospects as they were laid out for me of all of the advantages to West Virginia, and I saw precious few. And the day may come when I will be proven wrong. But it just seems to me that when large entities become larger, that somehow West Virginia manages to drop just a bit out of the picture.

That was part of the case of airline deregulation. I think it was superb for Houston and California and New York and other places, but it has been a disaster for West Virginia. We lost American, United, and Eastern within a very short period of the action which created that deregulation.

Now, I will not say ideologically that I am opposed to two big entities getting together if there is in fact an overall net increase of coal movement opportunity, and hence job opportunity, for the State of West Virginia. But on the other hand, part of what would appeal to me—and my mind is open on all of this—would be that the new corporation that is contemplated by the Secretary would have the size and the resource base to bring about, even if not from a particular line, from other resource areas within the company, the capacity for lower rail rates for the movement of coal.

I am about concluded in my own mind that the future of the coal industry in West Virginia is going to depend on two things. One is markets, which are much more difficult to control and have to do with international and national factors.

But second, rail rates. I have dealt with you and your people, Mr. Claytor, on the electric power system contracts, and matters of that sort, and indeed there has been a lowering of rates. Now, there are published rates and there are unpublished rates, and matters get very complicated. But I will also have to say that it was a quite a battle to get there, and that it took this Governor's office and a number of my people working on a daily basis with yours to achieve this result.

I come back to my question. Is it likely that this merger will enhance rail rate possibilities, that is, make them lesser, in West Virginia for those areas in which you serve and in which you will become competitive?

Mr. CLAYTOR. Senator, I would answer it this way. It has already occurred in the instance to which you referred, as far as the State of West Virginia is concerned, in the movement of West Virginia coal to the South. If we had not had the Norfolk & Western-Southern consolidation, there would be no coal being mined in Marrowbone, WV, today and moving to a powerplant at Sherer, GA.

And I can say that pretty confidently, because we did not care to move coal from West Virginia to the South and we had a good economic reason for not moving it, and I am talking Norfolk & Western, the old N&W. If our line did not go past Norton, VA, or Winston-Salem, NC, we did not get enough money.

We would rather have moved it to Chicago, we would have rather moved it to some other long haul point. And we worked to do that, and we were not much interested in reducing rates to a point in the South, which is Sherer, GA. So the coal, instead of coming from West Virginia, probably would have come from Tennessee or some other State. I do not know where in the South it would have come, but it probably would not have come from West Virginia.

And there was an example of a type of rate action which was made possible by the consolidation of two large railroads, which gives them a greater reach. The same thing applies to Conrail, and West Virginia coal would be able to move, for instance, to Pier 124 in Philadelphia, where it would be much needed to mix with good Pennsylvania coal, not to displace it, but to make it available to move in the export market, the metalurgical market overseas, and make it competitive.

Now, I think that this is a positive prospect for West Virginia coal, both from the point of view of cost and therefore rates, ultimately rates, and from the point of view of just simple service. So I think I can see nothing but positive effects from this consolidation as far as West Virginia is concerned.

Senator ROCKEFELLER. Thank you, sir.

The CHAIRMAN. Mr. Claytor, thank you very much. It may be that some Senators will have written questions to submit to you, if you can answer them for the record.

Mr. CLAYTOR. Thank you, sir.

[The statement follows:]

STATEMENT OF ROBERT B. CLAYTOR, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, NORFOLK SOUTHERN CORP.

My name is Robert B. Claytor. I am Chairman and Chief Executive Officer of Norfolk Southern Corporation, which owns Norfolk and Western Railway Company and Southern Railway Company. Prior to assuming my present post, I was President and Chief Executive Officer of Norfolk and Western. I have worked in the railroad industry for 34 years. Joining me today are some of my fellow Norfolk Southern officers.

I welcome the opportunity to testify before the Committee in support of Secretary Dole's acceptance of Norfolk Southern's offer to acquire the government's 85% stock interest in Conrail. At the conclusion of my testimony we will be glad to respond to any questions members of the Committee wish to ask.

Mr. Chairman, Norfolk Southern is pleased that Secretary Dole chose us to buy Conrail.

First, let me briefly refresh your recollection about our company. Norfolk Southern Corporation was formed as a holding company and in 1982 acquired ownership and control of two of America's finest rail carriers—Southern Railway Company and Norfolk and Western Railway Company. Our two railroads are operated from their own headquarters—Norfolk and Western in Roanoke, Virginia, and Southern Railway in Atlanta, Georgia. If Conrail were added to our system, as we hope it will be, it would be added as a third full partner to Norfolk and Western and Southern and would continue to be operated from its own headquarters in Philadelphia, Pennsylvania.

Norfolk Southern is a strong and financially sound company with assets in excess of $8 billion with more than $1 billion in cash and short-term investments. We have a favorable debt-equity ratio and in 1984 had net income of $482.2 million. And we pay substantial taxes, including federal, state and local taxes. Our pre-tax income last year was $839.2 million. This included current taxes of over $117 million and deferred taxes of almost $180 million.

Norfolk Southern's rail lines extend over 20 states in the Southeast and Midwestern sections of our country with miles of road approximating 18,000. Our chief rail competitor is the CSX system which covers almost all of the same territory we serve but, in addition, has lines extending into the Northeast section of the United States which we do not serve. One of the primary purposes of our proposed acquisition of Conrail and one of the plain public benefits from such acquisition is that it will enable the Norfolk Southern system to be competitive with the CSX system throughout the Northeastern territory. At present, Norfolk Southern does not extend north of Washington or east of Pittsburgh and Buffalo. Our proposal would increase competition in that important section of our country.

Today I want to discuss with the Committee our offer, the risks associated with leaving Conrail as a stand-alone operation, and the benefits a sale of Conrail to NS will bring to the government, Conrail employees, the region, shippers and the public through enhanced competition.

THE NORFOLK SOUTHERN OFFER

Norfolk Southern's offer for Conrail reflects a far-reaching commitment, in Congress' words, to ensure continued rail service while at the same time providing the maximum return to the government. Chart 1 attached to my statement summarizes the major components of our offer.

At the heart of our offer is cash to the government—$1.2 billion. The cash is Norfolk Southern's cash, not cash derived from leveraging Conrail assets. It will provide an immediate direct benefit to the government at the closing of the sale.

In the years to come the government will receive additional cash benefits from our surrender of Conrail's operating loss carryforwards and investment tax credits. In a normal business acquisition the acquiring company gets the benefit of operating loss carryforwards and investment tax credits. Norfolk Southern has been and will be a tax-paying railroad. The surrender of Conrail's $2.1 billion operating loss carryforwards and $275 million investment tax credits means that the combined NS-Conrail system will be paying more taxes in the years to come than it would have paid with these normal tax benefits. The government will benefit dollar-for-dollar from the $275 million investment tax credit surrender and, depending upon the applied tax rate, by almost $1.0 billion from the $2.1 billion operating loss surrender.

For its 85% ownership the government is not only getting immediate and future cash, but is avoiding the risk of a future outlay of cash by selling Conrail to a financially healthy company in the transportation business.

Further assurance that Conrail service will continue without direct or indirect subsidy is achieved by our agreement to covenants in the public interest. We agree to give up the easy abandonment procedures now enjoyed by Conrail. We agree to invest from $350 to $500 million annually in Conrail properties and to maintain Conrail properties to the high standards we maintain on our railroads. We agree to reopen routes to smaller carriers in the region. We agree to divest the lines necessary to satisfy the Jutice Department's condition for the assurance of long-term, viable competition between Buffalo and Pittsburgh on the east and Chicago and St. Louis on the west. We agree to refrain from drawing dividends from Conrail except to the extent of 40% of Conrail's net income after closing, and then only if a minimum cash balance of $500 million would remain. All of these covenants represent economic value.

We estimate reopening of routes to cost about $30 million a year in revenues. Selling lines to other carriers diverts to competitors over $100 million a year in traffic off the combined NS-Conrail system. When all of these factors are considered, the real price we are paying for the government's 85% equity in Conrail is far more than the $1.2 billion in cash we lay on the table on the closing day of this sale.

Our agreement under Secretary Dole's plan of sale includes even more than commitments to maintain Conrail, foster additional rail competition and reopen routes Conrail closed. Our agreement assures the return of Conrail employees to industry wage levels and adopts New York Dock labor protection benefits. Those benefits pay up to six years' wages for employees adversely affected by acquisition of Conrail. Conrail now pays terminated employees nothing. Under the Northeast Rail Service Act, the government pays labor protection benefits which often are less than even one year's wages.

Conrail employees have rights to acquire up to a 15% interest in Conrail through their employee stock ownership plan. We agree to pay $375 million for the employees' interests and claims. Again, we will pay that entirely from Nortolk Southern's assets, not Conrail's.

Our offer was accepted through a process of open competitive bidding. Experts can argue about what Conrail is worth in the abstract. Norfolk Southern has been advised by Shearson Lehman Brothers, whose view is available to the Committee. The more relevant question is what will a purchaser pay. The answer to that question is now before the Committee.

The terms of our offer to buy Conrail were hammered out during nearly a year of negotiations. Prior to submitting our bid to the Secretary on June 18, 1984, we spent months evaluating the Conrail property and getting a feel for the requirements the government would insist upon. Between June 18, 1984—the day we submitted our bid—and February 8, 1985—when we were selected—negotiations were almost continuous. We increased the cash on the table. We accepted conditions. We provided the Justice Department with detailed traffic data so it could consider the competitive effects of combining Norfolk Southern and Conrail. We agreed to divest certain rail lines to enable the formation of a new competitive rail system west of Buffalo and Pittsburgh.

Essentially, DOT conducted an auction. There were 14 bids submitted by the June 18 deadline, but no one has come forth with an offer to surpass or even match ours for the purchase of Conrail. This is so because Conrail is worth no more than our offer. As I have pointed out, our offer is real money and our money—not Conrail's. Conrail is of value to Norfolk Southern because of the way we fit together. Our offer was the highest because of the unique market extensions provided by the geographic location of Norfolk Southern and Conrail. Conrail permits Norfolk Southern to extend its markets north of Washington and east of Buffalo and Pittsburgh. Norfolk Southern permits Conrail to extend its markets south of Washington and Cincinnati and west to Kansas City.

The process established by Congress worked. Hard bargaining sorted out the bid that best met three criteria: (1) it leaves Conrail in the best financial condition after the sale, (2) it best assures long term rail service in the Conrail region, and (3) it realizes the best return to the taxpayer consistent with the first two requirements.

We based our final offer on the interplay of risk, projected Conrail earnings, and projected operating efficiencies and marketing benefits. One thing which never entered the equation, for us or probably any other bidder, was the amount the government has spent on Conrail. The fact that $600 million has gone into employee protection or $500 million into subsidy of predecessor railroad losses or several billion dollars into correcting other past problems simply does not speak to Conrail's present worth.

Earning power is a primary component of value. 1984 was an exceptionally good year for Conrail. Investors must look at an average year, not a peak. Nevertheless, if 1984 earnings are adjusted for extraordinary items, standard compensation, and taxes, the resulting net income is in the range of $200 to $250 million. We could not have justified our offer on projected Conrail earnings alone. The Norfolk Southern package far exceeds the value that might otherwise be realized from Conrail, because only Norfolk Southern and Conrail together can produce certain benefits: reduced economic risks through joining the Northeast and Southeast, operating efficiencies, and marketing enhancement.

These plus factors for us are also all major public interest benefits.

In short, our offer is fair because it was tested in the market. The Department of Transportation and its financial advisers recognize this. Our offer creates the least risk to the government—disposition of the government's interest is assured with no threat of a return to federal subsidies. This is important because the risks Conrail faces if it does not join Norfolk Southern will be assumed by the government eventually.

RISKS FACING CONRAIL

Conrail has uncertain prospects for any significant traffic growth. Attached to my statement is Chart 2 showing the sharp downward trend of its and its predecessors' ton miles over the past 20 years. Even after the creation of Conrail, freight tonnage declined significantly between 1977 and 1983.

We hope this twenty-year trend has reached bottom. More than that, we are committing extensive resources and the future of our company in the faith that we and Conrail together can change the trend.

But it is not a sure thing. Those who said 20, and 15 and 10 and 5 years ago that the decline had finally stopped were wrong. Anyone who thinks Conrail should be left to go it alone is betting against history. And the real loser of that bet would be the government.

With the decline of heavy industry in the Northeast, railroads in that region lost a large part of what had been their strong base in commodities—such as coal and steel—which were important to that region's smokestack industries. As might be expected, Conrail's growth is now heavily dependent on growth in merchandise traffic. In 1983, Conrail derived only 16.4% of its revenues from coal, coke and ore (less than one half of Norfolk Southern's percentage). Next came transportation equipment (15%), intermodal (12%), chemicals (12%), and food products (9%). Even though we regard Conrail's position in some of these merchandise markets as an advantage for Norfolk Southern, a diversification of our own traffic base, the fact remains that the long-term financial strength of a railroad often seems proportionate to its bulk commodity traffic base, and Conrail's is not as solid as Norfolk Southern's.

Increased capital costs as Conrail's rebuilt system begins to need more work in the late 80's and early 90's, coupled with continuing competitive pressures on yields, will create a demand for capital funds. Conrail may not be able to meet this demand from its operations and internal sources.

Accordingly, we believe that Conrail by itself would experience cash flow problems during the next ten years, with a serious negative cash flow by 1989 (on the assumption another serious recession does not occur until then) that steadily worsens through 1993. These estimates assume that Conrail pays reasonable dividends which most purchasers would ultimately expect. In short, Conrail's continued vitality as a stand-alone operation is highly questionable. Again, if Conrail cannot make it alone, the real loser will be the government when it faces yet another bailout of the Northeast rail sector.

To assure that Conrail can maintain service to the Northeast without receiving additional massive amounts of money from the public sector, it should become part of a strong and profitable rail system which offers both market extensions and operating efficiencies.

And Norfolk Southern is just such a system. It has a strong cash position which improved despite the recession, rising from under $400 million in 1977 to over $1 billion in 1984. At the same time debt was reduced and investments continued. We are firmly grounded, historically and for the foreseeable future, in bulk commodity and industrial markets, deriving 35% of our 1984 revenues from coal, coke and iron ore. In this respect, our traffic base complements Conrail's strength in consumer goods.

The acquisition will open new markets and ports in Conrail territory to Norfolk Southern's shippers and will open our traditional markets to Conrail's shippers. By offering single-system service over a wide geographic area and by serving customers with diverse needs, the NS-Conrail system can provide better service more efficiently than could either of the systems alone; moreover, each system will be less dependent upon revenues earned from transporting a particular commodity and upon the economic vitality of a single region of the country. The CSX system, BN-Frisco, UP-MoPac, Norfolk Southern, and the proposed Santa Fe-SP show the industry's universal recognition of the need to offer interterritorial service. Joined with Norfolk Southern, Conrail will no longer be marooned in the Northeast, but will be part of a financially strong interterritorial system.

In short, Conrail faces real risks. These are risks a purchaser must take into account, but Norfolk Southern has the unique advantage of being able to cushion the risks by diversifying the territory, markets and commodities available to either railroad by itself. Acceptance of our offer means Norfolk Southern will assume the risks, not the government.

BENEFITS

The benefits of a sale of Conrail to Norfolk Southern accrue to the government, Conrail employees, the Conrail region, shippers and the public through enhanced competition. I have already discussed the benefits to the government—(1) immediate cash, (2) future cash, (3) continuation of efficient rail service for the long term, and (4) no risk of having to take the railroad back.

Second, Conrail employees are assured the payment of full wages retroactive to July 1, 1984. Already this part of our offer has motivated Conrail management to restore the wages of some agreement employees. I would hope all Conrail employees could have wage restoration. They deserve it.

As I mentioned, our offer restores New York Dock labor protection of up to six years' pay for employees adversely affected by the consolidation. Perhaps more importantly, combining Conrail with our financially strong company assures long term employment. Moreover, our joint market extensions should mean more business and more jobs.

Conrail employees will get cash value for their ESOP and other interests. Our offer puts $375 million—of Norfolk Southern not Conrail funds—on the table. We are continuing to negotiate the details of payment with the labor organizations. We have also agreed to let Conrail agreement employees participate in the Norfolk Southern stock ownership plan for agreement employees whereby such employees can buy Norfolk Southern stock with the company paying part of the price. This provision alone is worth up to $15 million for the Conrail employees, depending on the level of participation.

Third, the region in which Conrail operates will receive major benefits. We will resume payment of state and local taxes not now paid by Conrail. Based on 1984 tax rates, this would amount to $30 million a year. Also, the region would be assured stronger rail service by being part of an interterritorial rail system, and will have the security of a viable rail system over the long term. In addition, longer single-system shipments will make the region more attractive for business location and growth.

Norfolk Southern's acquisition of Conrail will create a system roughly comparable to CSX, operating over high-density routes which, like CSX's, can effectively compete for both north-south and east-west flows. Reach and density are the keys to competitive rail service: reach to allow single-system service and density to operate efficiently and frequently. Through this unification, a number of important communities that are now dependent on the CSX system will gain a new competitive alternative with NS–Conrail service to and from the Southeast. These cities include Baltimore and Philadelphia as well as, for example:

Charleston, W. Va; Dayton, Ohio; Grand Rapids, Mich; Rochester, N.Y; Terre Haute, Ind; Wilmington, Del; and Youngstown, Ohio.

The more than 1,000 shippers who have endorsed the NS-Conrail combination reflect the improved transportation alternatives arising from it.

From the Midwest, Norfolk Southern's lines now reach no further into the Northeast than the far southwestern corner of Pennsylvania (at Connellsville and Pittsburgh) and the western corner of New York (at Buffalo). Norfolk Southern has no direct high-density east-West routes to the Northeast, and it serves directly no major East Coast port north of Norfolk, Virginia. As a result, Norfolk Southern has little business into these markets. Ports north of Norfolk will gain the opportunity to use their own individual natural advantages to tap the much larger territory served by NS-Conrail.

There have been a rash of scare stories about the harm to the region, particularly Pennsylvania, that would result from our purchase of Conrail, and I would like to put those to rest. One story has been that Norfolk Southern will favor the Norfolk port over the Philadelphia port. That is untrue. We will be able to increase business at Pier 124 in Philadelphia because we can mix low sulphur coal from mines on Norfolk Southern lines with higher sulphur coal on Conrail lines. That will mean more—not less—coal exported from Philadelphia.

We favor no port over any other port on Norfolk Southern. Economics govern a shipper's port of choice. The most efficient way from a mine to a port is always used when mine and port are on the same railroad. The combined NS-Conrail market extensions will help Philadelphia.

One newspaper account suggested we would move Conrail's headquarters out of Philadelphia. That is untrue. I had written Secretary Dole monts ago to assure her we will keep Conrail's headquarters in Philadelphia. We have made this commitment in our agreement with DOT.

Other scare tactics used by those who do not want this sale to succeed involve suggestions that jobs will be lost in the Altoona shops. Again the allegation is untrue. Altoona is one of the best shops in the country. We will use it more, not less.

Scare stories help no one. Unfortunately, such stories inflict pain on employees who needlessly worry about job security and can be particularly hard on Conrail employees who have had to sacrifice so much over the least three years.

Fourth, the shipping public will benefit from our purchase of Conrail because several features of the overall transaction will in fact operate to enhance competition.

The Antitrust Division of the Department of Justice conducted a six-month analysis of our proposed purchase of Conrail. The Justice Department gave its approval to our purchase, conditioned on a significant divestiture requirement that is more stringent than that imposed on any previous railroad merger. We believe the Justice Department review of our proposed purchase involved a higher degree of scrutiny than a normal ICC merger review. We will carry out Justice's divestiture mandate even though we do not entirely agree with its approach. For example, I believe sound railroad economics justified the combination of numerous eastern railroads into Conrail, and that the same logic could apply to the Midwest. Certainly, in most cases in the Midwest two railroads would provide entirely sufficient rail competition—this is the pattern in the Southeast, which has thrived through head-to-head competition between two big, healthy rail systems. A far less sweeping divestiture would have preserved two-railroad competition in the major affected markets.

Justice, however, insisted on keeping three or even four railroads in major markets where three or four were present today. Furthermore, I believe the extent and effectiveness of truck competition can hardly be overestimated. In Conrail territory trucks have 64% of the originated tonnage compared to 16% for all railroads. Even for commodities for which we would like to think rail has an advantage, trucks are tough competitors in this region, with 65% of the primary metals tonnage compared to rail's 33%, and 47% of the transportation equipment tonnage compared to rail's 46%. Justice, on the other hand, tended to put less emphasis on the role of trucks.

In any event, we have agreed to the divestiture condition and will be conveying rights to over 1,000 route miles and providing access to areas with combined NS-Conrail revenues of $1.4 billion. This divestiture will enhance the position of the acquiring regional railroads, potentially increasing their service area and the markets to which they have access, thereby making them more viable competitors in the Midwest.

A byproduct of the divestiture is a substantial reduction in the employment impact and extent of potential abandonments arising from the Norfolk Southern—Conrail consolidation. We think our initial estimate of 2,530 affected positions will be substantially reduced. These employees will receive up to six years of protection under New York Dock standards. The 1,250 route miles we thought we might seek ICC authority to abandon in the future will be reduced to 642 because of divestitures.

There has been much discussion regarding the impact of our purchase of Conrail on CSX. Even before reductions in the size of the NS-Conrail system through divestitures, Chart 3 attached to my statement shows how CSX's dominance over Norfolk Southern is redressed by the consolidation. CSX currently dominates Norfolk Southern in all traditional measures of business size; today CSX is 43% bigger than Norfolk Southern in a mileage comparison. After the purchase of Conrail, Norfolk Southern will be bigger under some measures; CSX will remain larger under others. In short, the argument that NS-Conrail will dwarf CSX is false; in fact, this purchase will substantially reduce the disparity in size between the two major rail systems east of the Mississippi.

Clearly, the primary reason for the CSX objection is that a Conrail purchase by NS will introduce competition into markets that are now dependent on CSX for a single system service to the Southeast. For example, Philadelphia, Rochester, N.Y., and Wilmington, Delaware, will benefit from a new competitive NS/Conrail alternative service. We welcome competition. It benefits shippers, and it helps us to run a better railroad. As the accompanying chart suggests, CSX's problem with this consolidation is not antitrust—their opposition reflects a fear of the competition that will result.

Finally, the shipping public will benefit from our acquisition because competition in the Northeast and Midwest should be be further enhanced by the reopening of gateways. Shippers at one time enjoyed rail competition because of the many interconnections Conrail made with other carriers. In its efforts to become a profitable carrier, Conrail closed many gateways to other carriers and cancelled thousands of joint rates. Norfolk Southern has agreed to reopen some of these gateways upon its acquisition of Conrail.

Mr. Chairman, Norfolk Southern wants to purchase Conrail. Secretary Dole wants to sell Conrail to Norfolk Southern. We urge you and your colleagues in Congress to pass the necessary legislation to complete the sale. We fully support the legislation the President has submitted to Congress to get the job done.

I will be happy to answer any questions the Committee wants to ask.

CHART 1.—NORFOLK SOUTHERN COMMITMENT

Cash to the government, plus any Conrail surplus cash—$1.2 billion.

For employee interests and claims, paid for entirely by Norfolk Southern with no use of Conrail assets or credit—$375 million.

Operating loss carryforward surrender—$2.1 billion.

Investment tax credit surrender—$275 million.

Guaranteed continuation of all economically justifiable Conrail freight services subject to full ICC abandonment procedures, for 5 years.

Guaranteed investment by Conrail of $350-$500 million annually in its properties and no deferred maintenance contrary to our own standards, for 5 years.

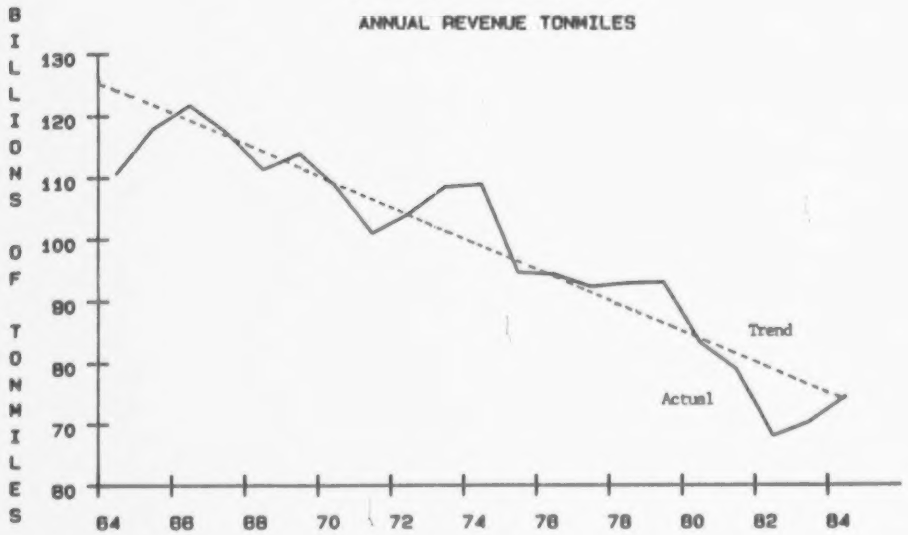
Limitation on payment of dividends on Conrail stock.

Divestiture of approximately 1,000 miles of lines linking Guilford, P&LE, and GTW.

Reopening of Conrail routes to smaller carriers in the region.

Chart 2

CONRAIL AND PREDECESSORS
ANNUAL REVENUE TONMILES



SOURCE: DATA COMPILED BY AAR FROM R-1 REPORTS

CHART 3.—THE DISPARITY BETWEEN THE TWO MAJOR EASTERN SYSTEMS IS REDUCED WHEN NORFOLK SOUTHERN JOINS CONRAIL

[In percent]

Subject of comparison	Disparity			
	Preacquisition		Postacquisition	
	CSX	NS	NS + CR	CSX
Miles of road	143	100	125	100
Revenue tons originated [1]	157	100	97	100
Merchandise	171	100	100	100
Coal, coke, ore	145	100	94	100
Revenue ton-miles	145	100	121	100
Originated carloads [1]	163	100	106	100
Merchandise	169	100	118	100
Coal, coke, ore	156	100	89	100
Number of ports	200	100	86	100

[1] OCS for 1983.

Note.—In several categories, NS + CR is still smaller than CSX. In the others, NS + CR is bigger than CSX, but by a smaller margin than CSX is now bigger than NS. Required divestitures, which will be reduced the size of NS + CR, are not reflected in these statistics.

(The following information was subsequently received for the record:)

QUESTIONS OF SENATOR LONG AND THE ANSWERS

Question. As a condition for Congressional approval of its proposed acquisition of Conrail, is Norfolk Southern willing to make a commitment that, after such acquisition, nothing will be done to eliminate, dilute or interfere with Conrail's present system of full compliance with Section 204 of the Staggers Rail Act of 1980?

Is Norfolk Southern willing to accept a provision in any bill drafted to approve such acquisition which would prohibit any action by Norfolk Southern or its rail subsidiaries to eliminate, dilute or interfere with Conrail's present system of full compliance with Section 204 of the Staggers Act?

Answer. Upon acquisition of Conrail, Norfolk Southern will not undo in any way the manner in which Conrail chose to comply with Section 204 of The Staggers Rail Act (codified in 49 U.S.C. § 10731(e)). Norfolk Southern would not object to appropriate language in any bill approving its acquisition of Conrail memorializing this commitment not to undo Conrial's compliance with Section 204.

Question. As a further condition for Congressional approval of its proposed acquisition of Conrail, is Norfolk Southern willing to make an additional commitment forthwith to bring its rail subsidiaries, Southern Railway and Norfolk and Western, into full, belated compliance with Section 204, especially in cases where compliance orders have been issued in ICC proceedings and the shippers involved have heretofore received no rate relief whatsoever under the statute?

Finally, is Norfolk Southern willing to accept a provision in any bill drafted to approve such acquisition which would require the merged railroads, and each of them, henceforth to maintain full, lawful compliance with Section 204 of the Staggers Act?

Answer. The Commission's 1981 decision in Ex Parte No. 394 ordered refunds and reductions in certain non-ferrous recyclable rates which exceeded 146 percent of variable costs on territorial average bases. Norfolk and Western and Southern Railway paid the refunds and made the required rate reductions. The Commission has agreed with these actions and has expressly found that we have complied. Accordingly, we believe we are in compliance with Section 204 and the Commission's implementing decisions. We are currently negotiating with recycling industry representatives concerning rates on important movements of ferrous recyclables.

QUESTIONS OF SENATOR RIEGLE AND THE ANSWERS

Question. What is the payback period for this investment by Norfolk Southern? Also, what is the internal rate of return generated by this acquisition?

Answer. We did not calculate the payback period but the estimated internal rate of return generated is 15% after tax.

Question. Why do you think that there was a unanimous vote by the rail unions against your proposal and in favor of the Allegheny plan?

How would you characterize the status of negotiations with the rail unions at this point? Also, how do you propose merging your employees, or current Conrail employees into the railroads which acquire your divested lines?

Answer. Negotiations with rail unions relative to the purchase of Conrail involve several general issues:

1. Consideration for past wage deferrals and employee interests in Conrail.
2. Protection to be afforded employees adversely affected by coordinations resulting from the acquisition.
3. Protection to be afforded Conrail employees in the absence of Title VII protection following acquisition.
4. Selection of forces or the rearrangement of forces due to coordination, sale or abandonment.

Negotiations to date have been over Items 1, 2 and 3 and involved the presidents of various rail unions as well as their financial adviser. While we have no agreement, there has been substantial progress between the parties so far as Items 1 and 2 are concerned. So far as Item 3 is concerned, we met what we believed was the unions' demand: to provide some type of protection to the Conrail employee who loses his job because of a perceived greater efficiency in operations under NS. However, some of the unions now seem to have backed away from their former position.

Negotiations under Item 4 would take place under the New York Dock protective conditions that Congress is being asked to make applicable. The local representatives of all the employees involved and appropriate management personnel would negotiate implementing agreements providing for the selection of forces from all employees involved on the basis accepted as appropriate for application in the particular case. Should the parties fail to reach agreement, the matter would be expeditiously arbitrated. This process cannot begin until it has been determined that NS will acquire Conrail. The same process would be followed in the sale of divested lines.

Norfolk Southern cannot speak for the unions in their actions in approving a sale to Allegheny and rejecting one to us. We have heard that some union leaders think our efficiency threatens the jobs of their members; some union leaders want an arrangement which would give them seats on our Board of Directors; and, some think Norfolk Southern is not providing enough protection over and above the six years' protection provided by *New York Dock*. But, that really is a question for the union leaders.

We believe the votes taken by the unions reflected such thinking. We are not aware of a unanimous vote against NS. The statement of Mr. Hardin before the Commerce Committee on February 28 would indicate that seven unions voted for NS. We also question the unanimity of the Allegheny vote, when a few days later a major union leader came cut in support of the Conrail management proposal.

Question. What efforts will you make to ensure that Grand Trunk continues to provide competition for you in Michigan or do you feel that divestiture to Guilford and PLE is sufficient to comply with the Department of Justice requirements?

Answer. Grand Trunk will continue to provide competition for NS/Conrail in Michigan, because no changes in the competitive situation are anticipated in the State of Michigan as a result of the acquisition. The Justice Department's first screen identified Washtenaw and Wayne Counties, Michigan, as possible problems. Conrail and NS do not serve any common stations or common customers in Washtenaw County, and, therefore, do not compete in the county. Norfolk Southern's only presence in Washtenaw County is a short section of rail line cutting across the extreme southeast corner of the county. Grand Trunk does not operate in Washtenaw County at all so it does not provide any competition for anyone at the present time, nor will it after NS acquisition of Conrail. In Wayne County Grand Trunk and CSX compete with Conrail and NS and will continue to compete after the consolidation.

Norfolk Southern is committed to the reestablishment of important joint routes with small carriers operating in Conrail territory. This commitment extends to Grand Trunk for routes which are competitively important to it. Norfolk Southern stands ready to discuss such routes with Grank Trunk. In addition the AAR/NITL accord on joint rates and routes affords Grand Trunk additional assurances of the opportunity to participate in competitive joint routes with NS/CR and its competitors.

The Justice Department requiremnts enhance Grand Trunk's position by providing Grand Trunk with an additional outlet at Toledo as a result of the proposed divestitures to Guilford and to Pittsburgh & Lake Erie. These new entrants into

Toledo will provide Grand Trunk with connections to the gateways at Chicago, East St. Louis, Buffalo, and Pittsburgh.

Question. How would you characterize the lines that you will be divesting to Guilford and P&LE, are they in top-notch condition, or will rehabilitation be necessary before they can carry increased traffic?

Answer. Lines to be conveyed to Guilford and PLE are in good condition. Out of about 1400 milies of line, 1100 miles are FRA Class III and IV. The remainder are branch lines which Guilford and PLE will continue to operate as branch lines. None of the lines will require new rail for the service anticipated. The St. Louis line will require a substantial number of new crossties to bring it up to Class III 40–50 mph level at which Guilford would operate the line.

Question. What evidence can you provide to substantiate the contention that the divestitute will provide real competition for Norfolk Southern? Does your evidence assume a certain level of traffic from Grand Trunk?

Answer. The Department of Justice, by its letter of January 29, 1985, Attachment A, requires that Norfolk Southern provide customers now served by Norfolk Southern and Conrail in the impacted counties with switching to the facilities of the acquiring carriers on terms and conditions customary at other locations within the region of the divestiture. Guilford and PLE will obtain access to the major gateways at Buffalo, Pittsburgh, Chicago, and St. Louis, giving them a chance to receive traffic from railroads located outside of the Official Territory, and will be provided direct access to railroads not affiliated with NS or CSX at the Buffalo, East St. Louis, Toledo, and Chicago gateways.

Norfolk Southern did not assume that a particular level of traffic from Grand Trunk would be available to the acquiring carriers. However, our conclusions on competition do take into account that Conrail and Grand Trunk currently exchange a large amount of traffic which might be divertible to Grand Trunk-Guilford or Grand Trunk-PLE routes at Toledo. This arrangement will provide Grand Trunk with connections that it does not now have to the gateways at St. Louis, Pittsburgh, and Buffalo.

The **Chairman.** That completes the day's hearings. We will be back at 9:30 tomorrow.

[Whereupon at 12:40 p.m., the committee was adjourned, to reconvene at 9:30 a.m. on Thursday, February 28, 1985.]

SALE OF CONRAIL

THURSDAY, FEBRUARY 28, 1985

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The committee met, pursuant to notice, at 9:35 a.m., in room SR-253, Russell Senate Office Building, Hon. John C. Danforth (chairman of the committee) presiding.

The CHAIRMAN. We are delighted to have two colleagues today as our leadoff witnesses, the two Senators from Pennsylvania, both of whom have taken a very active interest in the Conrail sale issue, Senator Specter and Senator Heinz.

Gentlemen, thank you for being with us. Senator Specter, would you like to proceed.

STATEMENT OF HON. ARLEN SPECTER, U.S. SENATOR FROM PENNSYLVANIA

Senator SPECTER. Thank you very much, Mr. Chairman.

At the outset, I express our appreciation for the many courtesies from you, Mr. Chairman, from your committee, and we appreciate this opportunity to be here this morning.

Mr. Chairman, I oppose the sale of Conrail to Norfolk Southern because, after extended study and hearings, it is my conclusion that the sale by the Government of Conrail to Norfolk Southern would be contrary to the national interest. Stated simply, the sale price is a steal, and it would render a death blow to competition affecting some 100 markets in 21 States.

When the issue arose—and I will submit a full statement, Mr. Chairman, which I would like to have made a part of the record, and I shall summarize it, hopefully in the interest of brevity. When the sale of Conrail was proposed early in 1984 and the bids were submitted in the spring, Senator Heinz and I began an intensive study of the issue because of its obvious impact on the Commonwealth of Pennsylvania, where there is the corporate headquarters, major repair yards at Holidaysburg and Conway, an employment picture of some 15,000 people, some 2,300 shippers, very vital interests of the Port of Philadelphia.

And it became obvious early on that a sale of Conrail to Norfolk Southern would be catastrophic to the interests of the Commonwealth of Pennsylvania. And as our own inquiries progressed, it became equally apparent that the sale of Conrail to Norfolk Southern would be contrary to the national interest, both in terms of the sale price and the very serious impact on competition.

As to the sales price, Mr. Chairman, a price of $1.2 billion for 85 percent of the stock is woefully inadequate. The Federal Government has put some $7 billion into Conrail. Conrail has a book value in the range of $4 billion. Conrail has a scrap value in excess of $3 billion. Conrail earned in its last year some $500 million.

True, if it were a private company those earnings would have been significantly less, but still in the $240 million range, demonstrating a value substantially in excess of what Norfolk Southern has offered for Conrail. The balance sheet of Conrail shows a large cash on hand at the end of last year of $849 million. The $200 million more are assets of Conrail in terms of excess funding for the pension plan. So that Conrail, in its current status, has cash on hand of $1.050 billion, and on its face that kind of a cash balance demonstrates, I would submit, that the value of the railroad is far in excess of the sale price which has been offered by Norfolk Southern and recommended by the Secretary of Transportation.

The Secretary of Transportation has approached this matter with diligence and I commend her for all of her efforts. But I sharply disagree with her about her conclusion that a sale to Conrail is in the national interest—a sale of Conrail to Norfolk Southern is in the national interest.

One critical question, Mr. Chairman, which has yet to be answered by the Secretary of Transportation is the value of the assets of Conrail. And back on August 7, 1984, I wrote to Secretary Dole and asked her directly, what was the value of the assets, such as rights-of-way, equipment, buildings, et cetera.

And then again on September 7, 1984, in a more extensive letter—and I would ask that both of these letters be made a part of the record—that question was repeated. And as of this moment the Secretary has not responded to that important question.

Last month at a hearing of the Northeast-Midwest Coalition, that question was again raised with Mr. Riley, who acknowledged the failure to answer and promised a response. But as yet no response has been received.

The same question was raised with Conrail at the same hearing of the Northeast-Midwest Coalition and, by letter dated February 22, which I received on February 27 from Stanley Crane, the salvage value of Conrail was placed at $3.016 billion, and an itemized statement. I would ask that this too be made a part of the record.

The representations made by Secretary Dole include the submission that Norfolk Southern would be giving up very material tax advantages which are on the books of Conrail at the present time. Be that as it may, Mr. Chairman, that is only part of the picture. The depreciation deductions that Norfolk would acquire under existing law on the book value, value for tax purposes, would give Norfolk Southern deductions of some $1.4 billion.

It hardly seems fair, given a sale price of $1.2 billion for 85 percent of the stock, to have the acquirer immediately have deductions worth $1.4 billion, a figure which is really in excess of the sale price all by itself. And that is why, Mr. Chairman, I think that it is accurate to say that the sale price of $1.2 billion for 85 percent of the stock is pure and simple a steal and ought not to be countenanced by the Congress of the United States.

It is true that no one has come forward as of this moment with a more substantial sale price. But I would suggest to this committee that the initial bid of $1.2 billion made by the first bidder has in effect been copied by all those who have made bids subsequently, and that as the picture has unfolded and the matter has been in the public view, it is apparent, I would say, in many quarters that the value of Conrail is substantially in excess of the bids which have been made.

That suggests to me, Mr. Chairman, that the appropriate answer may well be at this time that the Congress should do nothing about the proposal made by the Secretary of Transportation, a course of conduct with which we have had great experience. But I would say in this situation it would be more than justified by the facts at hand.

I believe that it is appropriate to sell Conrail, that it is philosophically undesirable to have one railroad which is held by the Government which has advantages that other railroads in the private sector do not have. But the issue as to whom to sell and when to sell is one which we have to approach with great care.

It is for that reason that I have introduced two bills, S. 464, which flatly prohibits the sale and would defer action by the Congress, giving us time to study this matter in some depth and to resubmit the property, Conrail, to the market, where I think we could get a substantially greater sales price.

And the second bill which I have introduced, S. 465, proposes a public sale of the stock of Conrail. Morgan Stanley has testified extensively in hearings which have been held by the Northeast-Midwest Coalition and by Senator Heinz and myself in Pennsylvania on the subject of the sale price, and Morgan Stanley has stated that there is a consortium ready, willing and able to guarantee $1.2 billion because of their confidence that they could sell in a public offering Conrail for substantially more than $1.2 billion.

And the estimates of Morgan Stanley are that Conrail would bring in the range of $1.5 to $1.6 billion, and it is my sense that as the picture unfolds an even greater price could be obtained for Conrail.

One of the points that Secretary Dole makes in the statement that she presented yesterday was that Conrail has a relatively brief earning record, and that is true. But the answer to that factor is not a hurried sale of Conrail, but permitting that earning record to be explored and to unfold in greater detail, to lead the market where I think we would have a substantially greater price offered for Conrail.

Mr. Chairman, of even greater importance than the sale price of Conrail is the devastating effect that the acquisition by Norfolk Southern would have on competition in this country. Norfolk Southern is an 18,000 mile track, Conrail is a 15,000 mile track. In an era of deregulation which we have adopted as a matter of national policy, it would be horrendous to allow Norfolk Southern, with its 18,000 miles, to acquire Conrail with its 15,000 miles.

The Department of Justice has considered this matter at length and the letter written by the Antitrust Division is an effort to squeeze an elephant through a funnel. They come to the conclusion that it may be possible under certain attenuated circumstances to pass antitrust muster, but that conclusion does not hold up on the basic facts as outlined in the Department of Justice letter.

Where you face a situation where there are 100 markets in 21 States which would be adversely affected by this acquisition, and where the solution lies in spinoffs to many smaller lines that are very thinly capitalized and cannot conceivably realistically present the kind of competition that is currently present between Conrail and Norfolk Southern, I suggest that most antitrust lawyers, perhaps any antitrust lawyer, who looked at this on an objective basis would say it simply violates directly the antitrust laws of the United States.

And I say that, Mr. Chairman, with some experience in the antitrust field in the private practice of law. But a reading of this letter shows an accommodation by the Department of Justice and an unsuccessful effort to squeeze that elephant through the funnel.

The consequences I think would just be absolutely disastrous from the point of the diminution of the competition. Included in the hearings which we have held has been extensive testimony from many, many shippers, illustrated by the testimony of National Steel, which provided facts that it is served by Conrail and Norfolk Southern on 12 of its important facilities, and if Norfolks acquires Conrail that competition will be lost. And that pattern is replicated again and again and again across the spectrum of the 21 States which would be affected adversely by this acquisition.

That is the essence of my concern, Mr. Chairman. I would like to submit for the record [1] a summary of testimony by numerous witnesses who have testified in hearings which have already been held by Senator Heinz and myself and by the Northeast-Midwest Coalition, starting in Harrisburg last October, Pittsburgh in December, Philadelphia in January, Pittsburgh again in February, and two hearings by the Northeast-Midwest Coalition in January and February of this year.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much, and your various submissions will be included in the record.

[The statement and letters referred to follow:]

STATEMENT OF HON. ARLEN SPECTER, U.S. SENATOR FROM PENNSYLVANIA

Mr. Chairman, and members of the committee, I appreciate this opportunity to testify on the proposed sale of Conrail, which is of vital interest to my state, the Commonwealth of Pennsylvania, as well as to the entire country.

I have been concerned about the sale of Conrail since last June when proposals were made by three private bidders. My first concern arose in connection with potential harmful consequences to Pennsylvania. However, during the course of my studies, and further review, I have become very much concerned about the proposed sale of Conrail in terms of the very serious, if not disastrous, consequences which will result for the entire Nation.

It is for that reason that I introduced two bills on February 19 of this year. The first bill, S. 464, blocks the proposed sale of Conrail to Norfolk Southern. The second bill, S. 465, provides that in the event that a sale of Conrail is deemed advisable at this time, it proceed by public stock offering, and not by private sale.

I arrived at the views which I hold as a result of extensive consultations with labor and business leaders, both within Pennsylvania and outside of my State, and after discussions with the Secretary of Transportation, Elizabeth Dole.

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[1] This material is in the Committee files.

In addition to those meetings, I have studied voluminous documents, and I have conducted six hearings on this subject—in Harrisburg in October, Philadelphia in December, Pittsburgh in January and February, and, along with Senator Dixon of Illinois, my Co-chair on the Northeast-Midwest Senate Coalition, in Washington, D.C. in January and February. As a result of these hearings, I am convinced that it would be strongly contrary to the national interest to proceed with the proposed sale of Conrail to Norfolk Southern.

The best starting point on this issue is to deal with an article published by the distinguished Secretary of Transportation, Elizabeth Dole, in the New York Times on Sunday, February 17.

I applaud Secretary Dole on her sincerity. But I must disagree with her both on her analysis of the facts, and on her conclusions as to what is best for the United States.

In the New York ~~Times~~ article, Secretary Dole refers to a review of the Norfolk Southern offer by the Department of Justice, and she concludes that there will be preservation of competition in the region now served by Conrail. My analysis of the facts convinces me that exactly the contrary is the case.

Today these two carriers, Conrail and Norfolk Southern, compete and have over 1,200 miles of parallel trackage throughout their systems. The proposed sale would combine the current 18,000 miles of Norfolk Southern track with 15,000 miles of Conrail track, and would have a very serious anticompetitive impact on the entire Nation.

The magnitude of the threat to competition is apparent when one considers that the combined rail system would have approximately 60 percent of the rail market in Michigan, 95 percent of the market in northeast Indiana, 70 percent of the southern Michigan steel traffic, 85 percent of the Cleveland grain traffic, and 94 percent of the eastbound New England/New York/Texas corridor rail traffic.

In fact, the Department of Justice itself noted in its January 29 report that the merger of Norfolk Southern and Conrail will have a "very serious anticompetitive effect."

It is apparent on the face of the Justice Department letter that Justice was straining to find some way to approve what the Secretary of Transportation wanted to accomplish. The final arbiter on the issue of compliance with the antitrust laws, however, is obviously not the Department of Justice, but the courts. I submit that lawsuits which have already been promised by the Chessie Railroad at hearings held by the Northeast-Midwest Coalition, will result in a round of litigation that will last a decade. The eventual conclusion will be to ban this proposed sale of Conrail to Norfolk Southern on the grounds that it would violate the antitrust laws.

The Department of Justice further outlined the fact that there would be anticompetitive effects in 100 markets, and in 21 States. The Justice report ignored the impact on the area east of Buffalo, Harrisburg, and Philadelphia, and further ignored antitrust problems which would be magnified by the consequences of abandonment of lines by the CSX Corporation. On the basis of the existing facts, there is, therefore, no question about a violation of the antitrust laws.

The second point that Secretary Dole makes is one relating to the best way to preserve service to Conrail shippers.

The conclusive evidence presented at the hearings which I have referred to discloses that there would be an adverse impact on shippers throughout the area served by Conrail within the Northeast-Midwest region.

Testimony, for example, by John Westhause, the Director of Traffic for National Steel, disclosed that competition would be obliterated in 12 markets where National Steel presently ships which are served by both Norfolk Southern and Conrail. Prices for National Steel would thus be raised. Similar testimony was given by Robert Corcoran, Director of Traffic for the United States Steel Corporation.

I suggest, Mr. Chairman, that it would be very harmful to add to the substantial costs which the American steel industry has already sustained in its battle to compete with foreign imports.

Testimony by many other shippers at these hearings, including PPG, Fort Pitt Consolidators, and Consolidation Coal, disclosed that they now benefit from the competition of Conrail and Norfolk Southern, and that such competition would be eliminated by the proposed merger.

Throughout the corridor presently served by Conrail, such disastrous effects upon shippers, especially small shippers, would result, thereby adding to the cost of goods sold, impacting upon consumers, and causing a very severe inflationary effect.

The next issue involves the assertion by Secretary Dole that the "public should gain the best possible return on its investment" by a sale of Conrail to Norfolk Southern.

A return to the taxpayers of $1.2 billion for 85 percent of the stock of Conrail is a very small price considering the following facts. First, the taxpayers have expended $7 billion to modernize Conrail. Second, the book value of Conrail is in excess of $4 billion at the present time. We have not yet had an itemization of the assets of Conrail, notwithstanding my request to Secretary Dole which has been pending since August of 1984. At the present time, Conrail has $1.050 billion in cash—some $850 million in a cash reserve, and $200 million in excess funding for the pension plan which is really cash available to Conrail.

On the basis of these undisputed facts, I suggest that $1.2 billion for 85 percent of the stock is a grossly low price to be received by the taxpayers of the United States and the U.S. Government and that, in any event, such a low price should preclude any sale at this time. The bidding may be reopened, and bids at a later date should not be hard to obtain, considering the fact that Conrail is currently earning profits of $500 million a year. Even without the tax breaks which Conrail presently receives as a governmental entity it would earn in the range of $230 million annually.

Secretary Dole further asserts in her New York Times article that the Conrail employees deserve to know what their futures hold. This assertion suggests that Conrail employees would be protected by the proposed sale to Norfolk Southern. The contrary is the fact. Norfolk Southern, in a recent press conference, conceded that at least 2,500 employees would lose their jobs, and the estimates I have received state that many times that number would, in fact, lose their employment.

The Secretary of Transportation further asserts that Conrail's Philadelphia offices would be retained. Such an assertion seems fine, but it is obviously inevitable that Norfolk Southern would eventually consolidate the headquarters with its Virginia-based operation.

One factor not considered by the Secretary of Transportation, which is of enormous importance to this Nation, is the competition offered by the Port of Philadelphia to the Port of Norfolk. If Norfolk Southern acquires Conrail, it will be only a short time before rail traffic will be diverted from the Port of Philadelphia—notwithstanding the $42 million investment recently made in that Port to triple the coal handling capacity, and notwithstanding the absence of competitive benefits which run to the shippers now able to choose between ports through which to send their coal and their other products.

I do agree with one assertion in Secretary Dole's article, and that is the statement that an acquisition by Norfolk Southern would provide long-term stability for the Conrail system. Mr. Chairman, I submit that the best way to provide maximum stability for the rail system in this country is to have one rail owner. But that is hardly the preferable course for this country, which thrives on competition. Further, it is too high a price to pay for stability to eliminate the competition which now benefits so many shippers throughout the areas now served by Conrail.

As to the issue of price, persuasive testimony has been adduced by investment bankers at Morgan Stanley and Company that a public sale would yield $300 to $400 million more than the $1.2 billion offered by Norfolk Southern. On the basis of this record, it is my conclusion that the national interest would be best served by not selling Conrail at all at this time.

I do agree as a matter of philosophy that it is desirable ultimately to return Conrail to the private sector because, over the long term, a government held railroad should not exist and compete with private railroads. But on its face, given the offer of $1.2 billion—which is totally inadequate according to the facts at hand—no sale would be the best alternative at the present time. If that fails, then I urge that the best alternative, if a sale is deemed advisable at this time, would be a public offering. A public sale would return the stock of Conrail to the American people and would, according to a very reliable estimate, yield $300 to $400 million more than the price being offered by Norfolk Southern.

Mr. Chairman, I think it is vitally necessary that the Senate of the United States focus on this issue at this time. Some suggestion has been made about folding the Conrail sale into the budget resolution, which I strongly oppose. But this matter will soon be before Congress on one day or another. These facts are matters of great importance which far transcend the cataclysmic consequences to the Commonwealth of Pennsylvania in terms of the loss of corporate headquarters, the loss of the repair yards in Hollidaysburg near Altoona and the impact on some 15,000 employees and 2,300 shippers. It is not in the national interst to sell Conrail to Norfolk Southern. Thank you.

U.S. SENATE,
Washington, DC, August 7, 1984.

Hon. ELIZABETH H. DOLE,
Secretary, Department of Transportation,
Washington, DC.

DEAR ELIZABETH: I am very much concerned about the continuing media reports concerning an imminent proposed agreement for the sale of Conrail. As I have reflected on our meeting of last week, it seems to me that there are a number of important outstanding questions which should be resolved before the sale price or the terms and conditions can be concluded.

As I mentioned to you during our meeting, I am interested to know the value of the assets (such as rights of way, equipment, buildings, etc.) after deducting the $300 million in cash and the $500 million in reserve for operating expenses. The value of such assets is obviously important in determining the total worth of Conrail.

Since talking to you, I have been advised that there is an extra $200 million in Conrail's assets in the form of excess funding of Conrail's pension plan beyond what is necessary for actuarial soundness. I am very much interested to know if you concur in that assessment or what your view is on the status of the funding of Conrail's pension plan.

Beyond the issue of value, I continue to be very concerned about retaining the branch lines in places like up-state Pennsylvania so that existing service will be maintained absent some very strong showing of cause or severe financial loss to the railroad by keeping such lines in existence. I am not yet satisfied that the ICC standards would be adequate, and it may be necessary to have convenants to guarantee adequate protection on this subject.

In addition, I would like to discuss with you further the impact, if any, on the existing labor force on any proposed sale.

As I mentioned to you during our meeting, I very well recall the investigation which I conducted as District Attorney of Philadelphia leading to the criminal prosecution of three key Penn Central executives in 1972. Those activities and other factors led to the demise of the Penn Central, and we want to be sure (as sure as we can) that rail service is continued without the necessity for involvement by the federal government at a later date. To accomplish that, it seems to me that we have to be very careful in the way the transaction is structured in addition to being sure that fair compensation is obtained on the sale.

For these reasons, I think it important that such questions be answered before a final price is established and the terms and conditions of the sale are set.

Thanks very much for your continuing consideration on this matter.

Sincerely,

ARLEN SPECTER,
U.S. Senator.

U.S. SENATE,
Washington, DC, September 7, 1984.

Hon. ELIZABETH H. DOLE,
Secretary, Department of Transportation,
Washington, DC.

DEAR ELIZABETH: Following our discussions on Conrail and my letter to you of August 7, I have discussed the Conrail situation with many people, including many Pennsylvanians, and I have concluded that a public offering of the Conrail stock is the best alternative in light of: (1) serious concerns about the future operation of Conrail by a new owner and (2) the relatively low offers which have been received considering the value of Conrail's assets.

While I would very much appreciate your responses to the questions raised in my letter of August 7, 1984 at your earliest convenience, my review of Conrail's assets demonstrates to me that Conrail is worth far more than has been offered by the private bidders. When I wrote to you on August 7, the value of Conrail (as reported to me) included $300 million in cash, $500 million in reserve for operating expenses and $200 million of excess funding for Conrail's pension plan beyond what was necessary for actuarial soundness. In addition, there were various other assets such as rights of way, equipment, buildings, etc. which would have substantial value.

Since early August, Conrail has increased its profits, as reported to me, in the range of $75 million to $95 million; and its projections for the immediate future suggest that there will be more cash surplus on hand. While I understand your interest in returning Conrail to private ownership, the offers which have been received seem to me clearly insufficient in the face of the assets of Conrail and its continuing profitability.

Accordingly, it is my thought that a public offering should be explored further as promptly as possible. I understand that the initial conclusion was that all the Conrail stock could not be sold to the public at one time. That may have changed in light of Conrail's increasing profitability. However, even if the stock cannot be sold at one time, it may make good sense to offer the stock in a series of public offerings. Such public offerings could be conditioned on the sale of 51% of the stock or some higher percentage or even all of the stock, so that if a satisfactory arrangement did not follow from the public offering, then a private sale could agains be considered. While I understand that there is some risk in having the current offers withdrawn, it seems to me to be a relatively small risk in light of the very modest offers which are pending at the present time.

A public offering would have the significant advantage of returning Conrail to private ownership while maintaining Conrail's management which has been so successful and which has been very solicitous of shippers' interests and the public's welfare generally. In conversations with many Pennsylvania users of Conrail, I have heard repeated concerns about what would happen if a new owner came into the picture contrasted with the very satisfactory current arrangement with Conrail. Also, I note that the British Government has had some significant success in public offerings selling off some nationalized corporations.

In addition, I continue to be very much concerned, as noted in my letter to you of August 7, about retaining branch lines in places like up-state Pennsylvania. Again, Conrail's existing management has a good record on that important subject, and there is substantial doubt about what a future owner would do on that matter. Continuation of the current Conrail operation is also the preferable course for Conrail's existing labor force and overall operations which impact vey heavily on Pennsylvania.

In addition to these considerations, the U.S. Government could see an immediate return of significant cash without a sale by Conrail's immediate payment of $145 million consisting of $60 million in interest on the $850 million in debentures and an $85 million payment for reduction of the principal debt. I am advised by Mr. L. Stanley Crane, Chairman and Chief Executive Officer, that Conrail is in a position to make such payments forthwith.

Since it now appears very unlikely that any proposed sale of Conrail could be reviewed, considered and approved by Congress in advance of our October 5 adjournment date, it seems to me that consideration should now be given to such a public offering; so I wanted to give you my thinking on the subject as promptly as possible. I am considering holding a public hearing in western Pennsylvania, perhaps Altoona, shortly after the October adjournment to get more of a feeling for the public's reaction to the sale of Conrail.

I look forward to continuing to work with you and your Department on the questions raised in this letter and my previous letter of August 7.

Thanks very much for your continuing consideration.

Sincerely,

ARLEN SPECTER,
U.S. Senator.

CONRAIL,
February 22, 1985.

Hon. ARLEN SPECTER,
Washington, DC.

DEAR SENATOR SPECTER: As you know, Conrail continues to feel that the best indication of the value of the Corporation is assuming its continuing use as an operating transportation company. However, at your request, we have conducted a liquidation analysis which indicates that the scrap value of assets currently owned is approximately $3 billion (Schedule 1).

The value of real estate and track assets included in the $3 billion figure cited above gives effect to the cost of removing and dismantling the track materials; and assumes sale of the real estate for other than rail services. The scrap value for locomotives and freight cars is based on Conrail's recent experience in disposing of such equipment.

As you know, the most modern equipment in Conrail's fleet is financed under leases in which ownership of the asset at lease end does not revert to Conrail. Therefore we have not included in this analysis any value associated with leased equipment. Further, associated with this equipment is the ongoing responsibility to make lease payments, which have a present value of approximately $946 million (Schedule 2).

If you or your staff have any questions concerning this information, Mr. Robert H. Platt, Executive Vice President-Finance & Administration is available to discuss it with you.

Sincerely yours,

L. STANLEY CRANE,
Chairman and Chief Executive officer.

SCHEDULE I—*Consolidated Rail Corporation*

	Millions
Track structures: [1]	
Salvage	$2,193
Removal cost	484
	1,709
Real estate [2]	1,094
Locomotives—owned [3]	20
Freight cars—owned	193
Total	3,016

[1] Includes rail, OTM, ties and turnouts, excludes bridges, tunnels, signals, ballast (considered retired in place), does not include buildings and value of property.

[2] Assumes 1/1/85 sale and no lines sold for continued rail service.

[3] 1,506 locomotives including approximately 300 currently retired units—sold on own wheels.

[4] 62,860 freight cars at scrap value less cut-up costs.

SCHEDULE 2—CONSOLIDATED RAIL CORPORATION

[Dollar amounts in millions]

	Leased assets				Capital lease obligations	
	Amount	Number capital leased units	Number total fleet units	Percent leased	Equipment	Present Value
Locomotives:						
Asset	$639	1,607	2,803	57	Locomotives	$461
Less amortization	241					
Net book	398					
Freight Cars:						
Asset	596	[1] 27,996	97,088	29	Freight cars	356
Less amortization	276					
Net book	320					
Other: [2]						
Asset	208				[2] Other	129
Less amortization	99					
Net book	109					
Total net book	827				Total capital lease obligations	946

[1] Excludes approximately 3,200 operating lease cars including trailer train flats.

[2] Includes EDP, M of W, M of E, Pier 124, highway vehicles, and building leases.

COMMONWEALTH OF PENNSYLVANIA,
OFFICE OF THE GOVERNOR,
Harrisburg, February 27, 1985.

Hon. JOHN HEINZ,
Hon. ARLEN SPECTER,
U.S. Senate, Washington, DC.

DEAR JOHN AND ARLEN: I am writing to follow up on our discussions concerning the proposed sale of Conrail to Norfolk Southern Corporation. You will be appearing shortly before the Senate Commerce, Science, and Transportation Committee which is considering this matter and I wanted you to have a formal statement of my views for your use and presentation to Chairman Danforth and his colleagues on the Committee.

As you know, the Conrail system affects Pennsylvania more than any other state and is critical to our economy. Almost one-fourth of the railroad's system mileage is within Pennsylvania, and much of the state's industry is dependent upon it. Conrail employs 15,000 men and women in Pennsylvania. Conrail purchased $133 million worth of goods and services, spent $67 million on track rehabilitation and paid $3.7 million in local government taxes in Pennsylvania in 1983. That same year net plant investments in Pennsylvania totalled $923 million as a result of Conrail's industrial development activities. Over two million tons of coal were shipped that year through the Pier 124 complex in Philadelphia, a facility recently expanded and modernized through an innovative partnership between the Commonwealth and Conrail.

This once bankrupt railroad has been turned into a profitable venture which provides Pennsylvania and the Northeast a strong rail system on which business can depend. Any transfer of Conrail into the private sector should result in a system which meets or exceeds Conrail's current high performance.

As I wrote to Secretary of Transportation Dole on July 16, 1984, I believe that any transfer of Conrail to the private sector be based on the following principles:

It must result in a strong railroad which will continue to invest in industrial development and preserve current jobs in the Northeast.

The type and level of cost-effective service now provided by Conrail to the states and shippers must be preserved.

Conrail should be maintained as a single entity. The existing Conrail mainline system must be preserved to protect the public investment in its properties and rebuilt infrastructure which constitutes an important portion of the national transportation system. Shippers in all regions of the nation would be adversely affected by actions to dismember the Conrail system or defer its maintenance.

There should be a commitment to maintain and utilize the existing infrastructure, including the headquarters and coal shipping facility at Pier 124 in Philadelphia.

It is also important to shippers and consumers that healthy competition in the relevant markets be maintained.

Unless and until these concerns are satisfactorily addressed, whatever the form of the transaction divesting the federal government of the present Conrail operations and properties, we would have serious misgivings about supporting any such transaction.

The memorandum of intent signed by Norfolk Southern seems to address some of the these principles; however, it leaves unclear how firmly committed Norfolk Southern would be toward them absent a definitive agreement. It fails to address some of the other principles at all. For example:

Freight service could indeed be impaired if railroad competition in the Northeast is reduced and the incentives for holding down freight rates removed.

Such stated intentions that Conrail will be operated "substantially" as it is now and service maintained to the maximum amount that is "economically justifiable" seem to be somewhat less than solid.

The existing infrastructure in Pennsylvania could be substantially bypassed and the Pier 124 facility in Philadelphia completely bypassed if Norfolk Southern elects to move freight and coal through its southern routes and ports.

There is no mention of maintaining jobs either throughout the Conrail system or at the Philadelphia headquarters.

In view of the open questions which could negatively impact upon freight service, jobs and economic development in Pennsylvania, I share the reservations you have expressed regarding the Norfolk Southern sale as presently constituted. I also feel that it would be appropriate for the Commerce, Science, and Transportation Committee to, at least, explore and assess the viability of a public sale.

My ultimate criteria for judging any transfer of Conrail to the private sector is whether it would meet or exceed the present performance of Conrail in Pennsylvania and the Northeast. I hope that you will urge the Committee to evaluate the currently proposed sale in terms of how well it meets the principles I first set forth last July 16 to Secretary Dole and the other concerns that we share.

Sincerely,

DICK THORNBURGH,
Governor.

The CHAIRMAN. Senator Heinz.

STATEMENT OF HON. JOHN HEINZ, U.S. SENATOR FROM PENNSYLVANIA

Senator HEINZ. Mr. Chairman, first I want to thank you for these hearings and inviting Senator Specter and myself to testify.

I would like to first summarize my point of view and then briefly detail why I take the particular point of view I do. Basically, the proposal by the Department of Transportation is going to create a mega-merger of two huge rail systems, that the shippers are against because it will eliminate competition at 5,557 service points, that labor is against because it will eliminate at least 2,300 jobs—that is what Norfolk Southern says—and that is a give-away of a $7 billion investment of the taxpayers' money for a mere $1.2 billion, which is just about exactly the amount of surplus cash that Conrail has in its treasury and pension fund combined.

I obviously strongly oppose the Department of Transportation proposal. Let me deal with the fact that it is grossly anticompetitive. The Department itself has said it wants to preserve service and competition.

Based on the available evidence, the merger of Conrail with Norfolk Southern would leave 5,557 individual shipping points in at least 12 markets bereft of access to competing lines. The antitrust remedy proposed by the Department of Justice will solve only a portion of those problems.

Because of that serious deterioration of competitive rail service, the proposal is going to drastically undermine the economy of the Northeast-Midwest region. It will not only cost Conrail workers at least 2,300 jobs—and that is the Norfolk Southern's promise—but it will cost tens of thousands of jobs on the premises of those manufacturers and shippers who depend on Conrail services and the competition from other rail lines currently accessible, because those shippers either will be bereft of any service or the cost of their transportation will rise dramatically because they will be captive shipping-points.

I also must say, Mr. Chairman, that the proposal that is before you from the Department of Transportation is not going to go anywhere and achieve the intended objective of the Northeast Rail Service Improvement Act, and I do not think it is going to go anyplace for three reasons:

The first is the tax elements of this proposal. Now, it just so happens that the Finance Committee, on which the chairman and I both serve, has jurisdiction and should have jurisdiction over the tax aspects of this proposal.

This proposal has some of the most intricate, precedent-setting tax provisions that I have ever seen. And I will name one that should be of great concern to every member of the Finance Committee and every Member of the House and Senate. As I understand the proposal, we would be presented with legislation which would eliminate the investment tax credit that has accumulated over the years to Conrail, in return for which the same legislation proposes to write up the depreciable base of the assets in this corporation.

Mr. Chairman, until we go over it and it is found by the experts on the Finance Committee to be something else, that looks like one of the great hidden tax give-aways to the special interests in this century. And we should not just sit here pontificating about it. We should be examining it in the committee of jurisdiction, and certainly I intend to insist on referrals to the Finance Committee, on which you serve, so that we can properly examine it.

Second, the antitrust questions are significant and serious. How can they not be significant when 17,000 miles of Norfolk Southern track, as Senator Specter has mentioned, are being merged with 13,000 or 14,000 miles of Conrail lines to create the largest railroad in the history of the United States?

What about the competitive effects of those 5,557 service points? I do believe that the Senate Judiciary Committee must, indeed is obligated to, demand referral and to evaluate the antitrust components of this sale. Having a little report from the Justice Department that says all is well here in Mudville is simply not good enough.

Let me give you the third reason, Mr. Chairman, why I do not think this proposal to privatize Conrail is going to go anyplace. There is a rumor that this sale is going to go some place because it is going to be included in budget reconciliation.

Now, we all know what difficulty we are having putting together a budget reconciliation package. We all know that, if we're going to reduce spending by $50 billion, we are going to have in that budget proposal about $200 worth of pain for every man, woman, and child in the United States of America.

That is what those budget cuts would amount to, and that legislation, if it passes, is not going to pass by a very large margin. And I do not think that including a controversial Conrail sale proposal that affects the economic lifeblood of the Northeast and Midwest is exactly going to help that budget proposal along.

And if you want me to be plainer, if you want me to answer your unasked question, Senator, does that mean that I would vote against reconciliation if we put the Department's proposal in here as it stands, the answer is probably a very strong yes.

Now, let me address another point, Mr. Chairman. I am not opposed to the privatization of Conrail. Indeed, I support the Secretary's goal of privatizing Conrail. I would like to see it happen, if we can do it the right way, sooner as opposed to later. Sooner is more advantageous for a variety of reasons that we all know about.

But I do not think that having privatization just for its own sake is the answer, particularly when there is at least one alternative to the anticompetitive, antijobs, economically catastrophic-for-the-region Norfolk Southern megamerger. That alternative is a public offering.

There are many kinds of public offerings: Some are good and some are bad. A public offering that contemplates $500 million in equity is not a good public offering; $500 million in equity is the same as selling Conrail to the Marriott Corp., which is going to put up $500 million, and that means that the other $700 million is going to come out of Conrail.

It is going to come out of Conrail's cash, this $849 million. If it is not cash, it is going to come out of hypothecated assets of Conrail, which at some point have to be paid off with cash generated later. That is not in the best interest of Conrail.

It is not in the best interest of Conrail because Conrail may need, if and when we go into another economic downturn, the cushion of its cash. It is going to need the ability to borrow, perhaps, to get through the economic cycle.

There are better public offerings, however. A public offering that results in substantially all of the revenue of $1.2 billion being generated through the sale of common stock, equity, is a good public offering, because it results in no utilization of Conrail's cash, and because it results in no significant hypothecation of Conrail's assets, which gives Conrail the strongest possible means of moving ahead.

What I am here to urge you to consider is a particular kind of public offering, and that is a public offering where the public has a chance to vote with their wallets, and determine the future of Conrail. If the public chooses not to invest in Conrail, if the public offering fails, we go to plan B, which is whatever plan you, Mr. Chairman, and the Congress together with you decide.

What I am saying is that I urge you to write, for all the reasons aforementioned, a single piece of legislation that requires that the Secretary use her best efforts to bring about a public offering. If after a 60- or 90-day period of marketing of that public offering—the costs of which would be borne by an underwriter or group of underwriters—$1.2 billion worth of common stock had not been subscribed—an amount equal to or greater than that offered by Norfolk Southern—then we would go, because it is in the same piece of legislation, to plan B, which is whatever Congress shall prescribe.

It seems to me, Mr. Chairman, that this is an option that the committee ought to seriously consider. I am aware that there is some concern about the efficacy of a public offering, but I would note that yesterday, when you asked Secretary Dole's investment banker, Ken Brody, to comment on my proposal for a contingent public offering, he carefully did not say anything about it, and addressed something else. I do not know what. I was not here. But he certainly did not, as an examination of the hearing record will show, respond to your question in that regard.

The efficacy of a public offering generally has been questioned because no one has been able to identify as yet an underwriter who would do the typical kind of public offering. The typical kind of public offering is where an underwriter says we will on such and such a date deliver to you $1.2 billion, and if we do not get all the stock sold, it comes out of us, the underwriter.

That is the typical kind of public offering. I am proposing a different kind of public offering where if the $1.2 billion is not delivered on a specific date, you go to plan B. I would suspect, Mr. Chairman, that there are two ways you can test the efficacy of my proposal.

Test No. 1 is to examine the asset structure of Conrail as Senator Specter has proposed. Now, we are at a disadvantage. We cannot get the list of all the assets of Conrail, but we do have a list of the cash in Conrail, and the cash in Conrail is $849 million plus whatever money Conrail has made over the past 2 months, which is probably several more million dollars, plus $200 million surplus in the pension fund, plus whatever the net asset value is of the $3 to $4 to $5 billions' worth of rolling stock, rail, scrap value, and everything else makes up the railroad. I do not know what that is, but it is certainly worth several billions of dollars, I would think.

It seems inconceivable to me that any underwriter worth his salt could not sell $1.1 billion of cash plus $2 or $3 billions' worth of net assets for a measly $1.2 billion, and I suggest you ask them whether they can do it or not on the basis I have described.

Test No. 2 is to get some underwriters in here to tell you whether or not, based on the formulation I have given you, they would singly or in combination be willing to risk the marketing costs of this kind of contingent public offering, which marketing costs are substantial, at least as they measure it.

From what I understand, it would cost between $5 and $10 million to market the contingent public offering that I have proposed. Now, in Washington, DC, Mr. Chairman, $5 to $10 million is kind of laughed at. We do not even count it in the budget process. We just put a little asterisk beside it and say it is all right.

The Budget Committee does not even oppose amendments as long as they are under $50 billion in the budget. However, for a real flesh-and-blood business firm in this country, $5 to $10 million is a substantial amount of money.

So, if you get an underwriter that says, we are willing to risk $5 or $10 million to market this, you have somebody who is willing to put his reputation and his neck on the line here, and I hope you will bear that in mind.

Mr. Chairman, I want to conclude by simply saying that I think you have a tough job. What makes it tough is that there is a lot that you are being asked to do that is not typically in the jurisdiction of this committee.

The antitrust questions clearly need the expertise of the Judiciary Committee. They are raised specifically by the merger with Norfolk Southern. The tax questions, which are raised by the sale to any private entity, are clearly in the jurisdiction of the Finance Committee.

For the most part, those questions would not arise through a public offering. Indeed, a public offering would be not unlike what exists now with respect to Conrail except we would no longer have a nationalized railroad competing against free enterprise, other railroads, shippers, bargers, and air freighters, as indeed now is the case.

So, I hope, Mr. Chairman, that you will look into the issues that I have outlined for you. I hope that the committee will rise to the challenge of framing a different kind of legislative proposal.

Otherwise, I fear the committee will frustrate the very intent of NERSA, which is to find an intelligent way, not any old way, of returning Conrail to where it ultimately belongs; namely, in the private sector.

I thank you, Mr. Chairman.

Senator SPECTER. Mr. Chairman, if I may, I would like to introduce a letter for the record [1] which Governor Thornburgh of Pennsylvania has submitted to Senator Heinz, and myself. Senator Heinz' staff and my staff have been in continuous contact with the Governor's staff, and Senator Heinz, Governor Thornburgh.

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[1] See p. 111.

And I met earlier this week and discussed this issue extensively, and at that time the Governor asked that we submit to this committee a letter which he would prepare and he since has prepared, dated February 28 of this year—February 27 of this year.

The essence of Governor Thornburgh's concern is expressed in terms of a prior letter which he had written to the Secretary of Transportation on July 16 concerning principles which he believes would have to be observed. First, any sale must result in a strong railroad which will continue to invest in industrial development and preserve current jobs in the northeast.

Second, the type and level of cost-effective service now provided by Conrail to the States and shippers must be preserved. Third, Conrail should be maintained as a single entity. He has delineated that further in a paragraph. Fourth, there should be a commitment to maintain and utilize the existing infrastructure, including the headquarters and coal shipping facility at Pier 124 in Philadelphia.

And then Governor Thornburgh later in the letter says that the proposal to sell to Norfolk Southern fails to address some of the other principles. For example, freight service could indeed be impaired if railroad competition in the Northeast is reduced and the incentives for holding down freight rates removed.

Second, such stated intentions that Conrail will be operated substantially as it is now, and service maintained to the maximum extent that is economically justifiable seemed to be somewhat less than solid.

Third, the existing infrastructure in Pennsylvania could be substantially bypassed at the Pier 124 facility in Philadelphia, completely bypassed if Norfolk Southern elects to move freight and coal through its southern routes and ports.

And third, no mention of maintaining jobs either throughout the Conrail system or at the Philadelphia headquarters. With respect to the last point, I note that Secretary Dole has referred to a covenant as to headquarters being maintained at Philadelphia for 5 years, but I believe that a fair reading of that covenant discloses that its duration is too short, and its enforcenent is really impractical.

Mr. Chairman, I would like to cite just one part of the long letter from the Department of Justice on this antitrust question. The Department of Justice letter runs nine single-spaced pages, and has six pages of exhibits, something that we know as lawyers when you write an opinion letter that long something is wrong. But this is the key part and the introduction on page 1:

> As explained below, on the basis of our independent investigation, we have concluded that without appropriate divestitures, the proposed merger would violate both Clayton and Interstate Commerce Act merger review standards.
>
> The merger would have a significant adverse effect on competition for the transport of commodities to and from a number of locations in several states, with the greatest adverse effect occurring at locations along an east-west rail corridor running between Buffalo and Pittsburgh in the east and St. Louis and Chicago in the west.

That may be worth repeating:

> St. Louis and Chicago in the west. The merger would likely enable the merged entity to achieve certain efficiencies. These efficiencies do not appear, however, to be sufficiently great to offset all of the competitive effects in all of the affected markets.

Now, if you listen to that it states flatly, it violates the antitrust laws, and the letter goes on in the second paragraph to say:

> The Department of Justice therefore would oppose the proposed merger unless its competitive problems are remedied through a prior or concurred divestiture of assets that is approved by the Attorney General.

Later in the letter there are numerous references to the problems of passing antitrust muster, as illustrated by the reference to, "Our concern is particularly acute because a number of competing railroads would be reduced from 2 to 1 in a certain area." And later, in questioning the issue on diversion of interchange traffic, saying, "It is extremely difficult to estimate the size and future diversions."

This letter has been cited, Mr. Chairman, Senator Hollings, as authority for the proposal that the Justice Department approves this merger. Now, you can read it that way, or you can read it to say that you cannot squeeze the elephant through the funnel, but I believe that what has to be remembered here is that the friendly Department of Justice—friendly to the Department of Transportation—does not make the ultimate judgment as to whether there is compliance—and Senator Rockefeller—as to whether there is compliance with the antitrust provisions.

That judgment is made in the courts. In one of our hearings, Mr. Chairman, and I would like to amplify the recitation of the six hearings which had been held independently by Senator Heinz, myself, and the Northeast-Midwest Coalition, that in those 6 hearings we heard some 49 witnesses, and we have made available to this committee summaries of the testimony.

And one of those witnesses was from the Chessie Railroad, which was enormously concerned about the antitrust aspects of the merger, and promised litigation in the courts which would be estimated to be in the range of a decade. This kind of litigation can take practically forever, the way litigation is handled, and given the ingenuity of lawyers, and given the enormous complex factual problems and legal issues which are involved here.

Senator Heinz has put the issue very well in referring to the matters which have to be considered by the Finance Committee on which he serves, and to protect the national interest and Pennsylvania's interest, and the Judiciary Committee, which will have to consider the antitrust implications. And I have already written to Senator Thurmond to ask for a referral to the committee on which I serve again to look after the national interest and Pennsylvania's interest.

But it would be inviting a long litigation process which would likely end in stalemate if this sale, the Norfolk Southern, proceeds, even with congressional approval.

Thank you very much.

The CHAIRMAN. Gentlemen, thank you very much. I know no more formidable combatants in any contest in the Senate than the two Senators from Pennsylvania. You are both very able in representing the interests of your constituents. I know you put a great deal of time in considering the Conrail matter, and I take it from your comments that you will continue to put a great deal of time on this matter.

Senator SPECTER. We intend to fight, Mr. Chairman.

Senator HEINZ. Not only that. We are also here to help you.

The CHAIRMAN. We always appreciate your help.

Senator Hollings.

Senator HOLLINGS. Mr. Chairman, I wish I had gone to divinity school and could be as generous and understanding as you are.

The CHAIRMAN. I wish you had, too.

Senator HOLLINGS. Most respectfully of my colleagues, I apologize as I did not get here in time to hear the entire statement. We have, you know, numerous committees—because Conrail goes through urban areas, maybe we should refer it to the Housing and Urban Affairs Committee.

Senator HEINZ. That is not a bad idea. I am ranking on that one.

Senator HOLLINGS. I know when you hear that a letter or article is nine pages long, it must have considered many items. In fact, questions were asked yesterday about that with regard to the Justice report. But let me get to one point with our limited time, Senators.

Senator Heinz, you said that the option of the sale of stock was not seriously considered. That question was definitely asked and covered yesterday, and we live in the land of reality. The head of Norfolk Southern came and attested to the fact that he had $1.5 billion in cash.

In this day of Carl Icahns and Boone Pickenses running around loose, that is a dangerous statement to make, that you have got $1.5 billion in cash. Now, he has publicly put on the record all the billions that he has in cash, and our good friend, Bill Greider, whom we also respect, has written a nine-page article stating that something must be wrong with it.

Senator HEINZ. In Rolling Stone.

Senator HOLLINGS. That is right. Greider writes very thoroughly. The article is just a mistake in assumptions. We will have to have his points answered. I think he raises quite a few points that we in the committee would want to look at. But there is no question that if you follow his article, even the people in Rolling Stone know that this is a wonderful deal.

We have had 2 years, 1983 to 1985, of competition going on. We have had the head of Conrail leading the fight to try to do exactly what you have said. I mean, it was not just a senatorial idea. For 2 years we have all been talking on the Hill, about public offerings.

And in the land of reality, the proof of the pudding is in the eating. It is right out there. They could long since have done it. When you admonish the committee to start bringing in underwriters, we started with the best of underwriters and perhaps the best of railroad experts yesterday.

They cited their own citations in this particular regard, specifically that they had looked at the public offering and they did not think it was a good venture at all. With all the money available, and the Boone Pickens crowd and everybody running around loose looking for takeovers, I am confident that the committee would not have to run around and bring in securities people if the market were out there.

There would be many others bringing a firm proposal. As Secretary Dole says, she has been waiting, and looking at all ideas over a 2½ year period, and there has been no firm public offering proposal, Senator, that has come to this particular committee.

There have been 15 different submissions that were reduced to six and then to three, and then she seriously considered all of those three, and all the time the matter of the public offering as well. So I do not think you can say that the committee has not seriously considered the public offering option. It has been seriously considered for the committee as indicated in the presentation yesterday.

I thank you, Mr. Chairman.

Senator HEINZ. May I respond?

Senator HOLLINGS. Certainly, please.

Senator HEINZ. I do not remember exactly at what point you came in, but I had drawn in my remarks a distinction between two kinds of public offerings, one where an underwriter says, we will deliver to you $1.2 billion this date certain either from the public or from ourselves, and certainly that is the kind of public offering that a lot of people have been talking about, and I have no doubt that it was talked about last summer and last year, but it is not the kind of public offering that I then went on to describe as an alternative.

The second kind of public offering is more akin, interestingly, to a Boone Pickens takeover bid or a Carl Icahn takeover bid. What happens in a takeover when two companies are trying to merge one another out of existence? In effect, the investment banker for the acquirer says: Your stock is trading at $50 a share; we will offer your shareholders $55 a share; you have 30 days to put up or not. If at the end of 30 days you have not tendered to us 80 percent of the outstanding common stock of corporation X, we are going to return your money and we are out the marketing costs or the takeover costs.

What I am proposing, Fritz, is a form of a tender offer. It is no fault of the committee's, but that particular line of public offering has not been explored and I think an examination of the hearing record would support that contention. When Ken Brody of Goldman, Sachs was asked yesterday to comment on the feasibility of my proposal, he did not even attempt to answer the question. He gave some other answer. He ducked on the issue of a contingent public offering, what I have described as kind of a tender offer to the public for Conrail.

I am convinced the public will vote with their wallets by coming forward for Conrail. Anecdotally, I might tell you that, as Senator Specter and I have gone singly and together throughout our State, we find lots of Conrail family members, relatives, cousins, who would love to own a piece of Conrail if they were to be given a chance.

British Telecom sold an enormous amount of stock a few months ago in a capital market that is a fraction the size of ours. I just simply urge the committee not to take my word for it, but to get the informed word on this second kind of public offering on the record.

By the way, there is at least one underwriter who has come to me and said, we are willing to risk the $5 or $10 million to do a public offering of Conrail and I will be happy to supply you and the rest of the committee with that underwriter's name and address. It is a major investment banking firm on Wall Street.

Senator HOLLINGS. Senator Heinz, we went into the British Telecom offer. That has concerned the committee members, and that was definitely and explicitly distinguished from any kind of offer that could be made here.

Specifically, this Norfolk Southern bid has been described as a sort of takeover kind of offer. The market is there and there have been many options out there that have been examined in every regard.

There is a rear guard action, if I could go into the other point where you say that the competition, Senator Specter, in the Northeast is rather diminished. On the contrary, this is exactly the incentive for Norfolk Southern to enhance that competition.

They went right into the point of bringing it all the way to Washington and then to get to Philadelphia they piggyback. They have to offload all of their trucks, because they just do not have that connection with Conrail. But having obtained Conrail, they will take a lot of the trucks off the highways and move to rail service and enhance the service and come up to the size of CSX in the competition in the Northeast. In other words, the purchase will enhance the competition, and that is the big incentive that they have to come in at this particular point.

But you and we will have plenty of time to discuss that. We do appreciate your appearance.

Senator SPECTER. Senator Hollings, the facts are that in 21 States, in 100 markets, in more than 5,000 points, competition will be reduced by the acquisition.

Senator HOLLINGS. That is one way to look at it. The glass is half empty and the glass is half full. Norfolk Southern is filling the glass——

Senator SPECTER. My glass is all empty, Senator Hollings, and that is this deal.

Senator HOLLINGS. Well, we are going to fill it with this particular Conrail sale.

The CHAIRMAN. Senator Rockefeller.

[No response.]

THE CHAIRMAN. Senator Ford.

Senator FORD. Yes, Mr. Chairman. I will be glad to fill the Senator's glass with a Kentucky product and we will all be happy.

THE CHAIRMAN. Senator Gorton?

[No response.]

The CHAIRMAN. I wanted to say to you gentlemen, I appreciated your testimony. You have been certainly very strong, very forceful.

My own view, for whatever it is worth, is that the exact amount of the purchase price is secondary or even tertiary on our list of priorities. The most important thing is to provide strong rail transportation for the Northeast and Midwest in the foreseeable future. With respect to purchase price, it is purely speculative that there would be any better price attained by a public offering, and we may end up with less of a price. We do not know the answer to that.

I have always thought that the best way to set the price of anything was to offer it for sale and see what the market produced. I think that the market has spoken in this case. I further think, just in response to your testimony, that the question of salvage value in this case is not particularly relevant to anything.

Hopefully Conrail is not going to be liquidated. In fact, that is among the covenants attached to the sale of Conrail. We are selling a going entity, not something that will be scrapped and sold for salvage. Those are my comments on the purchase price.

Senator HEINZ. Mr. Chairman, would you entertain a 60-second closing comment?

The CHAIRMAN. Absolutely.

Senator HEINZ. The thrust of my argument to the committee today has been that if you are serious about doing something about returning Conrail to the private sector where it ultimately belongs, you will consider a contingent public offering as an alternative to DOT's plan. If you try to ram through a specific solution on which there is no consensus, you may not get any solution at all.

What I have proposed to you is one bill that provides an opportunity for a public offering, and, should that fail, an alternate form of sale. If the public offering does not result in the same amount of money that the Government would otherwise get from Norfolk Southern $1.2 billion, we would implement an alternate disposition plan, perhaps a sale to is Norfolk Southern, if that is the will of the committee and the Congress.

It seems to me that what you have on one hand is something that is very offensive to a lot of people—Norfolk Southern. On the other hand, you have something that people are a little nervous about—the public offering. And how do you get enough votes to pass anything?

And the answer is, I think you give everybody something in a way that does not risk attaining your ultimate objective. It seems to me you risk nothing by giving the public a window, maybe 60 or 90 days, to vote with their wallets, to purchase Conrail through a public offering. And you will actually attain the goal of privatizing Conrail sooner because legislation which gives everybody something will move a lot faster than extremely controversial legislation which helps no one but Norfolk Southern.

That is really the thrust of what I have been trying to say, after you peel away some of the facts, figures, and rhetoric.

Senator HOLLINGS. Mr. Chairman, if you please. Senator Heinz, I would take exception to the description "ram through." You know this committee is not going to ram through anything.

Senator HEINZ. Mr. Chairman, I apologize. This committee is always fair. It may make errors of judgment on occasion, but it is always fair.

Senator HOLLINGS. Well, that is the point. I mean, if we do not take your approach or your solution, then we are being characterized as ramming something through. You have got the time, and we will be around here this time next week, and I will meet you here in April or a month or so from now. If you have those underwriters who have come, you know good and well that if it is a fine kind of offer, it will be presented to the Congress, if not on this side perhaps on the House side.

There is no big rush about it. Some time this year it ought to be handled, and everyone is on notice, as you and I have agreed. Even the readers of "The Rolling Stone" know all about this and the possibilities of making a fortune by taking over Conrail. Now, if we are down to that point where "The Rolling Stone" readers understand it, then you and I and everybody out there know it.

So all we are waiting for is the market to respond, and if it does not respond—and it has not—then do not allude to our ramming just because we are not perhaps agreeing with your particular approach.

Senator HEINZ. I thank the ranking minority member for correcting my characterization of the committee. I am certain this committee would never intend to ram through anything, even though the facts and circumstances might point in an opposite direction.

And I cannot help but observe that a rolling stone gathers no moss, either.

The CHAIRMAN. Gentlemen, thank you very much for your testimony.

Senator Lautenberg and Senator Moynihan; Senator Lautenberg, I knew you could not stay away. I am glad you are back.

STATEMENT OF HON. FRANK R. LAUTENBERG, U.S. SENATOR FROM NEW JERSEY

Senator LAUTENBERG. It is good to be here. Mr. Chairman and former colleagues on the Commerce Committee, let me say I miss you. Not to at all persuade you of any different viewpoint than you might have; I just want you to know how much affection I have for all of you on the committee.

Senator Moynihan and I both are members of the Environment Committee. There is a markup, and therefore, if you do not mind, I will go ahead with my statement and then Pat will make his remarks, and whatever questions you have we will be pleased to answer in crisp form.

First, if I might, it is a pleasure to be back here at the Commerce Committee. I am usually on the other side of the table, and I feel a certain twinge at not being over there. One of my great regrets in leaving the committee is that I will not be able to participate as fully as I would like in the discussions and deliberations on the Conrail sale.

Mr. Chairman, you know that I have spent a considerable amount of time on the Conrail issue. My interest in the proposed sale continues to be very strong. This past Monday I held a forum in New York City on the regional implications of the Conrail sale. I heard from shippers, labor, New Jersey officials, the port authority people, Norfolk Southern, Stan Crane, other railroads and other interested parties.

At the hearing we had expressions of support for Norfolk Southern, but we had very strong opposition to the sale expressed as well, which cannot be ignored. There is not a consensus in the

Northeast on this sale or the conditions on which it should go forward.

My message to the committee is this: It would be a fundamental mistake for the administration or the committee to fast-track this sale. A deal like this cannot be forced on one of Conrail's major service areas, cannot be forced on Conrail's employees.

A proposal of this magnitude in terms of taxpayer dollars, potential economic disruption, and possible job loss must be thoroughly examined and justified. The burden of proof should be on those proposing change. Mr. Chairman, I would like to remind the committee on the scope of what you are dealing with. The decision you make will have a lasting effect in the States of New Jersey, New York, Pennsylvania, Delaware, Ohio, Michigan, Indiana, Illinois, West Virginia, Missouri, to name only some.

The process followed by the Department of Transportation has been an internal one. It has been conducted behind closed doors, because that is the nature of a negotiated sale. But affected parties have had only 20 days to assess the implications of the sale as outlined. They have raised legitimate concerns about the sale as proposed. These concerns need to be addressed on their merits.

The legislation implementing the proposed Conrail sale deserves to be considered on its own. It has no place on a reconciliation package. It should not be fast-tracked. It is not a fire sale.

Let me run through the major concerns that exist in the Northeast about the Conrail sale. I would like to share with you, at a minimum, what is expected if the Conrail sale is to proceed with support from the Northeast. Northeast ports like New York and Philadelphia must be assured that their traffic will not be diverted to southern ports. Our ports can compete.

We do not want special treatment, but we cannot sit still for unfair treatment. NS is conducting extensive discussions with the port authority of New York and New Jersey. These negotiations must be complete before a sale is consummated. Norfolk Southern has routes in the South. In the Northeast there is a substantial concern that our ports will see their traffic diverted elsewhere as a result of this sale. Business in the Port of New York and New Jersey represents 3 percent of our regional economy. It represents $14 billion in economic activity, $4.2 billion in wages, $500 million in taxes paid, and 192,000 jobs. We cannot run the risk of bias.

Captive States like New Jersey, with no alternative rail service, must not suffer even higher rates or a loss of service as a result of this sale. They must not suffer wholesale abandonment of branch lines, leaving companies without access to their markets.

The administration's desire to sell Conrail must not result in a fire sale that burns the American taxpayer. I agree with the chairman's remarks earlier about price not being a primary factor. It is a significant factor, but that is not the motivating factor. The public deserves to get a fair price and a fair value for its sacrifice. $7 billion tax dollars have been poured into the railroad and we have to make sure that the fare is not too cheap for the long ride.

One nagging suspicion that could be addressed in this regard is the treatment of nonoperating profits that might be experienced by Conrail. Railroads have a value beyond the assets necessary for operations, such as access to the right of way. A covenant stipulating that profits realized through nonoperating transactions be returned to the Government deserves serious consideration, and in fairness Norfolk Southern said that they would consider that in the testimony that we had the other day.

Conrail's headquarters must be maintained in Philadelphia without a loss of jobs. Norfolk Southern has stated in writing that they will retain Conrail's headquarters in Philadelphia, but the covenant including this protection is not quite strong enough.

As one witness pointed out to me in New York, Norfolk Southern could meet the terms of this covenant by keeping their corporate offices on the 17th floor of Conrail's existing headquarters. I am concerned about the other 16 floors that they occupy. Norfolk Southern has offered to discuss a longer and broader covenant, which is deeply appreciated. That needs to be done.

The workers employed by Conrail have sacrificed to keep this railroad viable. They deserve to be made whole in this transaction. The views of the Railway Labor Executives Association must be given considerable weight in any deliberations.

Mr. Chairman, Conrail management has turned in an outstanding performance in returning this railroad to profitability. Stan Crane has done an outstanding job and he enjoys substantial credibility with New Jersey shippers and all railroaders as well. He suggested that Conrail be returned to the private sector via public offering of Conrail stock.

My colleagues from Pennsylvania whom you just heard share some of the same concerns—who share some of the same concerns that I have, do support this proposal. But a public offering preserves the status quo. It maintains jobs, competition, and the existing management team. However, the suggestion has to undergo the same scrutiny as the sale proposal that we have before us.

The question is whether—a public offering could be done; it might work. The question is whether in the long term the financial interests of Conrail and the region it serves would be served by a public offering. It raises the question of whether Conrail standing alone can withstand an economic downturn? Will the public continue to invest, if needed, when profits and revenues are slipping?

Conrail is not British Telecom. It is not a monopoly It is a railroad. A public offering must be evaluated in terms of its relevance to a railroad and not to a telecommunications company.

The committee and the Congress have some tough choices to make in considering the Secretary's recommendations. Three options are being debated: Sell Conrail to Norfolk Southern, accept the concept of a public offering, or leave it alone as it is.

I share the view that privatization is the best way to go, so I would not recommend leaving it as it is if we can find a better alternative. Mr. Chairman, these three options that I have just outlined are too narrow. There is no reason why Congress needs to artificially limit itself in this very complicated and important matter.

The bid made by Allegheny Corp. is not before this committee today. It should be. Unlike the Norfolk Southern bid, Allegheny does not carry with it the potential loss of jobs, reduction in competition, and the perception of a regional bias. Their bid, like Norfolk Southern's, has its strengths and liabilities. But it deserves the detailed scrutiny of this committee.

Mr. Chairman, I know that you will move deliberately and judiciously on this matter. The concerns of our region must be addressed before the committee or the Congress moves toward final approval of sale.

I appreciate the opportunity for putting my concerns of my State before you and the members of the committee.

The CHAIRMAN. Thank you, Senator Lautenberg.

Senator Moynihan.

STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. Mr. Chairman, I have a statement which I would like to make for the record, as Senator Lautenberg and I have to be in the Committee on Environment and Public Works marking up the Superfund legislation. I can state my views in a fairly brief compass and my colleague Senator D'Amato will carry on and I think probably we can speak in a general range of agreement among the three of us here.

Conrail is important to New York's transportation system and economy, just as it is to New Jersey and to Pennsylvania. The major historic rail lines, the New York Central, the Erie, are part of Conrail, and we have almost one-fifth of the trackage.

Let me say a friendly word on behalf of Secretary Dole. I think she has taken the instructions of the Congress in the 1981 legislation and carried them out with great fidelity, energy, enterprise. This is scarcely a matter delegated to others. It is something she has been very deeply involved in herself.

And I think that, while one may not agree with her final judgments, but they are scarcely to be dismissed as not hers or not serious. To the contrary, her selection criteria, which are to leave Conrail in a strong financial position and to preserve the services to shipping and to get some return to the taxpayers, as much as can be done by sale, it seems to me were sound and the process has been thorough.

It began almost 3 years ago. One hundred potential buyers were met with, were offered a chance to make bids. In the end some did. And then in February a recommendation came from her on behalf of Norfolk Southern.

It need not be the final decision. It comes back under the statute. Obviously, this is a good time to sell Conrail. The system became profitable in 1981, and in 1984 it ran a profit of $497 million, which is more than what Congress can say. When was the last time we had a surplus of half a billion dollars?

There are things we would like in New York to have considered before the final sale. We have concerns about maintaining a competitive rail service in this system. The Department of Justice has identified some areas, Buffalo in particular, as having problems.

We would like to see the provision of trackage rights to competing railroads preserved. We are very much concerned that the rail service be maintained on what we call the southern tier, the route of the old Erie Railroad, which is an important route.

Those of you who are railroad buffs, Erie was built with a 6-foot track, and we would be happier if the whole of the system had been a 6-foot track now, and its clearances and such like can carry piggyback flatbed cars as no other parts of the U.S. railroad system can do. And there is a whole economy along that line, as you know.

Our third concern is that in New York City we have an intermodal system called the Harlem River intermodal system, where truck and rail fits together. We want to make sure that is in place. And in particular I want to join Senator Lautenberg, and I am sure Senator D'Amato will agree, we do want to make sure that our Port of New York and New Jersey is not abandoned in this process. It happens to be the finest natural harbor in the world and it is important to our economy and to our sense of ourselves and to all of those things.

And here is a matter where the railroads that make up Conrail graded New York as the maritime center of the nation. It was the Erie Railroad and the New York Central that made the Port of New York, first the Erie Canal and then the railroads. And we do not want an agreement negotiated here in Congress to unmake what is, after all, a century and a half of our history.

Thank you, Mr. Chairman.

The CHAIRMAN. Gentlemen, thank you very much. You are both in a markup now, and I do not know it there are any questions for you, but my idea would be to take questions for you two first and then get to Senator D'Amato. Any questions?

Senator HOLLINGS. Mr. Chairman.

Senator Moynihan, I have worked with the Port of New York, and they have been a wonderful help to us. And Senators Lautenberg and Moynihan, the whole point is that you are not going to diminish the service to the Northeast. If this kind of acquisition is in any way a diminution of the service or damaging to the rail service there in the Northeast, this Congress is not going to go along with it, and I do not think it should. And we are looking at that very carefully.

The statement made about the Allegheny proposal. Now, I have a staffer looking at just that right now. I understood that Mr. Crane under that particular proposal could continue to run it, and that it was a pretty competitive bid. That bid is before us, and the Marriott bid too.

We are looking at those bids—you say they are not before the committee. We are just starting—you say fast-track. We do not have the bill—it will be next week before we have the bill, and it would be my hope that we will not just fast-track and race through. We want to hear from shippers in the Northeast as to what is going to happen to their service.

When we have Senate colleagues commenting about ramming behind closed doors and fast tracking, you know, it just stirs up everything. Now, you, Senator Lautenberg, are a good businessman, and you are serious about this matter and have been holding hearings. So I know as a business leader the great concern you have.

You find me that public offering that will go along and include all of the covenants that Secretary Dole has obtained from Norfolk Southern, plus the one that you have added on about not cleaning out the first 16 floors of the headquarters building in Philadelphia—I would like to put that one in.

You get me that public offering, and I will support you. I mean, we are not wedded to Norfolk Southern or anything else. We are trying to get the best bid and the continuity of service to really run a railroad, but we do not see other alternatives at this time.

But do not accuse us of not even considering options. The public offering is being considered every day, and maybe you, as the best business leader there in New Jersey, could find a couple of pals this weekend to put up the money.

Senator LAUTENBERG. We would not buy it, me and my pals.

Senator HOLLINGS. I am confident that the railroad business is just not that good. That is why you do not find Boone Pickens running around and picking up that billion and a half that Norfolk Southern comes in here and openly says it has in cash just sitting there. Now why does not Boone Pickens pick up on that one? He does not want to get caught with a railroad. I do not know anybody that does.

The CHAIRMAN. Any questions for Senators Lautenberg or Moynihan?

[No response.]

The CHAIRMAN. Gentlemen, thank you very much.

Senator D'Amato.

STATEMENT OF HON. ALFONSE M. D'AMATO, U.S. SENATOR FROM NEW YORK

Senator D'AMATO. Thank you very much, Mr. Chairman.

Mr. Chairman, generally we ask to submit our remarks for the record in order to expedite the progress of the hearing. I am going to depart from that practice because I would probably spend more time attempting to summarize my remarks than if I just read them.

First of all, Mr. Chairman, I thank you for the opportunity to appear with my colleagues and to make some observations on the sale of Conrail. Although I was unable to be here when Secretary of Transportation Elizabeth Dole testified yesterday, I would like to state for the record that I have discussed transportation matters with her on a number of occasions, being a member of the Subcommittee on Transportation in the Appropriations Committee and the Subcommittee on Housing and Urban Affairs in the Banking Committee. The sale of Conrail is not only an important national issue, but it will directly affect rail freight transportation in New York State.

I believe Secretary Dole deserves to be congratulated on the responsible and diligent manner in which she has tackled the very complex, difficult task of returning Conrail to the private sector as intended by Congress. With the public interest foremost in mind, she has recommended that the Nation's freight railroad be transferred to a private owner through the process of a negotiated sale to a responsible bidder.

Norfolk Southern Corp. has now been selected as the Secretary's choice for owner and operator of Conrail. The Department of Transportation and the Norfolk Southern Corp. have signed a nonbinding memorandum of intent concerning that sale. This document embodies the major terms and provisions to be included in the definitive agreement planned to be executed and delivered following passage of the required implementing legislation.

There is no doubt that the sale of Conrail presents many complex issues. Their resolution must be one that has as its objective the protection of the best interests of the 15 States through which the Conrail system travels, as well as the long-term national interest in a healthy rail transportation network.

Congress must, through a thoughtful and conscientious process, examine these issues one by one and arrive at a consensus that permits the orderly return of Conrail to the private sector. I think that is one of the most important considerations, that the transfer be made in an orderly manner, without disruption in service.

Our work here must assure that Conrail has the best possible opportunity to remain a viable entity, because in the private sector it will be stripped of special tax exemptions, expedited abandonment procedures, and other Federal assistance. Our duty is to reduce, to the greatest extent possible, the risks that Conrail will ever again become a Federal responsibility or fail in its primary mission of being a viable transportation network.

Conrail is now the only effective means of moving freight by rail in New York State. With approximately 6,000 New Yorkers employed by Conrail and with the railroad providing an essential freight line to our region, it is imperative that the best possible buyer be found for Conrail. New York and the Northeast must be assured quality rail service over the long term.

A viable, healthy rail system is vital to the economic health and well-being of our industries and our communities. The public interest demands that the buyer be financially sound and possess the clear intent to operate a profitable rail freight system, and not merely to reap the rewards of a financial investment.

When the Justice Department completed its evaluation of the antitrust implications of a sale to the Norfolk Southern Corp., it identified Buffalo as one of the four cities—Pittsburgh, St. Louis, and Chicago were also included—most heavily impacted by a proposed sale. Local officials and shippers have told me that the impact upon Buffalo could be devastating.

However, they also view this critical stage in the sale as one which provides us the opportunity to enhance rail competition in the area. Since the contract of sale must remove any objectionable anticompetitive results of the purchase by Norfolk Southern, it can serve as the basis for improved service and increased access to the Buffalo area.

Currently there are five railroads serving this area. However, Conrail has severely limited their access to customers located on track which it owns. Since Conrail has controlled 90 percent of the rail freight service in the region, there has been little competition in the past. The time is ripe to improve this situation.

I urge the Secretary to meet with the New York State Transportation officials, as well as the local officials and shippers, to work out a plan which could become part of that sale agreement. There are various options available for increasing competition among the railroads in the Buffalo-Niagara Falls region.

For example, we could transfer portions of the Conrail lines to a neutral regional carrier, which would help reduce the costs, open up competition, and maintain rail employment. We could open the gateway to Buffalo by instituting reciprocal switching on terms more favorable than under current rules. Or we could sell off pieces of the Conrail tracks to various competing rail carriers.

It is also critical that the new owners of Conrail continue the existing levels of service to New York City and will be willing to add additional services in the future. During the past 25 years, New York City, like the rest of the Northeast, has endured a steady decline in rail service, as well as the deterioration of the physical condition of its rail network.

The bankruptcy of the region's major railroads left New York City shippers with abandoned rail yards and clearance restrictions which have become increasingly more of a problem as railroads move to more modern, larger equipment. Both New York State—and Senator Moynihan has alluded to this—and the Port of New York and New Jersey have developed a capital improvement program totaling $150 million that is well under way and seeks to address some of these concerns.

Obviously, we are most interested in the continuity of rail freight service being assured. We must now assure that the transfer of Conrail to the private sector does not harm the competitive abilities of the Port of New York and New Jersey.

New York City, which is captive to Conrail, must not have its gateways or interchanges closed. Neither must joint rates and through rates available to New York City shippers be increased or canceled. The continuity and integrity of the city's rail freight network must be maintained.

The long-term protection of Conrail employees is also of great concern to me. We must assure that Conrail continues to be a profitable, strong rail system with plenty of traffic. In that way, we can best guarantee the existence of the jobs. Congress has been assured that Conrail headquarters will remain in Philadelphia, which is significant to maintaining its reflection of the interests of the Northeastern States.

I would also like to add that Conrail employees, through their sacrifices, played a major role in Conrail achieving its profitability today. Further, many of these employees suffered through the collapse of the Penn Central and the other bankrupt carriers. We in Congress must remember that there are many working men and women who deserve prompt action and an answer to the current uncertainty as to what will happen to Conrail.

It is most important that the sale of Conrail yield the highest possible return to the taxpayers' investment in the system, consistent with the paramount public interest of preserving service and leaving Conrail in the strongest possible financial condition after that sale. A financially sound buyer is the best insurance to guard against Conrail ending up once again at the Federal doorstep looking for a public subsidy.

Finally, the sale of Conrail will mean that it will once again become a taxpayer worth over $30 million annually to the Northeast and Midwest. New York State alone is losing $4.6 million per year in State taxes because Conrail is now exempt from State taxes.

There has been much talk about a public offering of Conrail stock. I have serious questions about whether it is feasible to sell such a huge volume of Conrail stock and get a return greater than, or even equal to, the price a negotiated sale can offer. Moreover, I am concerned that a public offering would leave Conrail in a vulnerable and financially weakened position. After all we have endured with the rail crises in the Northeast, we must not support a sale plan that contains an unreasonable element of risk. Our considerable efforts to assist Conrail and the expenditure of taxpayers' money must not be undone with another railroad business failure in the future.

I think the committee for permitting me to offer my comments. Again, I thank the Secretary for her efforts and I urge the committee to act promptly to report out the legislation needed to return Conrail to the private sector.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator D'Amato, thank you very much.

Senator D'AMATO. Thank you, Mr. Chairman.

Senator HOLLINGS. Thank you very much.

The CHAIRMAN. Thank you, Senator.

I am going to have to, at about 11:30, leave for another meeting for what I hope is a short time. So I think what we will do now is to take Mr. Crane, if he is here, out of order as the next witness.

Mr. Crane, before you testify let me say to you that I know that there are controversies which the committee is considering relating to the sale of Conrail. Disagreement has already been expressed today on how we should proceed, whether there should be some form of public offering, whether there should be a sale to Norfolk Southern or a private sale to somebody else.

I know that you have a point of view which you want to share with us, and whatever that point of view—and I know what it is—it is going to be controversial, and there are differences of opinion on it. There is one thing on which there is absolutely no difference of opinion, and it is a view that is universally held and strongly held, and that is that you have performed an outstanding service to Conrail, to rail transportation in our country, and indeed to the country as a whole during your stewardship of Conrail. You have won the admiration and the thanks of all of us, and I think that the universally held view, is that no one in this country could have done a finer job than you did in turning Conrail from something which was in a very shaky condition a few years ago into something which is not only viable today, but something that 15 different bidders want to pick up and continue to operate.

That is largely your doing. I know, having talked to you in the past, that you give the credit to your team, but you were the manager of the team and you were the captain of the team and you put it all together. I think that you deserve the credit and the admiration and the gratitude of all of us on the Commerce Committee and in the Congress, indeed all of us in the country, for an absolutely outstanding service to our country and to the transportation industry.

Please proceed.

STATEMENT OF L. STANLEY CRANE, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CONSOLIDATED RAIL CORP.

Mr. Crane. Thank you, Mr. Chairman.

I cannot let the opportunity pass without noting that it was done by the people at Conrail. The management, its employees, both union and nonunion, its shippers in the territory it served, all contributed to the performance of the company.

I do appreciate the opportunity to meet with you and the other members of the committee this morning and to thank you for the opportunity to discuss Conrail's vital importance as a transportation company for the Nation. I hope my full statement will be entered into the record.

Briefly, right now I would like to discuss why Conrail management supports a public offering of the stock as the best way to return Conrail to the private sector, our deep concern about the anticompetitive impact of the Norfolk Southern takeover of Conrail, and some financial benefits and tax breaks which Norfolk Southern will receive in acquiring Conrail.

It is my opinion that an independent Conrail with an independent management and an independent board of directors, accountable to a broad base of stockholders, has the greatest incentive to serve the long-term interests of shippers and communities and to demonstrate a willingness to make the investments and commitments required to maintain quality service.

The public stock offering approach to return Conrail to the private sector ensures such a corporate structure and will permit Conrail to be managed for long-term financial viability, with business decisions based on traffic and revenue available to the company.

Senator Riegle. Mr. Crane, could I ask you to pull the mike closer. I know those people in the back of the room want to hear you.

Mr. Crane. Very good. Thank you, Senator.

The DOT has sought to address these vital, but variable, elements by insisting on restrictive covenants in the sales document. Conrail's proposal can meet all of the covenants which apply to a public offering. However, I wish to point out that you cannot covenant traffic and revenue levels. Management must have flexibility to anticipate future events and effectively react to the marketplace.

Conrail's shippers are supportive of an independent Conrail because such a company would preserve the Northeast-Midwest rail system. For the first time in many years, shippers in the Northeast and the Midwest have a competitive rail system, Conrail, that works.

In fact, in a "Distribution Magazine" survey shippers voted Conrail the best railroad in the country in 1984. Scores of Conrail's shippers have communicated to us and to Government officials their satisfaction with the excellent service provided by the company and their opposition to Conrail's acquisition by Norfolk Southern.

Most recently, in testimony before Senator Frank Lautenberg in New York City on February 25, four of our customers—United Parcel Service, Union Camp, American Cyanamid, and Witco Chemical—all testified to the high quality of Conrail service and the highly competitive transportation company Conrail had become. Not one of them expressed anything but the greatest concern over a Norfolk Southern takeover of Conrail, and all four cited the public offering plan near or at the top of their list as the way to return Conrail to the private sector.

An NS takeover means starting the whole process all over again, dismantling substantial portions of the existing system, setting new market strategies, reducing the commitment to industry in our service territory, and, most of all, eliminating the competition that is fundamentally responsible for the high quality of service and competitive rates that Conrail shippers have come to count on.

Conrail and Norfolk Southern compete directly and vigorously for traffic worth more than $500 million a year in rail revenue. As a result, shippers, receivers, and consumers benefit. A takeover of Conrail by NS means a total loss of that type of competition and a real loss to our shippers in dollars and cents.

There is another aspect of competition between Conrail and NS, called geographic competition, where the railroads are not running side by side, but rather compete because their customers compete. Let me give you an example of how Conrail's very existence stimulates geographic competition, Norfolk Southern and Conrail, serve competing coalfields in West Virginia and Pennsylvania respectively, which are desirable sources of coal for coal-fired utilities in New England.

When Conrail offered a more attractive price for coal to be transported to the utility, the utility pressured NS to reduce their prices. NS adamantly refused to change its price initially, but then the forces of the marketplace took over.

The utility used public forums to suggest that it would buy the more competitive coal from the Conrail-served mines. The NS-served mine announced that if it lost the coal contracts hundreds of jobs would be lost and the mine might have to close. State officials and others who viewed the NS action as anticompetitive exerted pressure on NS, forcing Norfolk Southern to establish a more competitive price. In fact, by being an aggressive competitor Conrail continued to participate in a portion of the coal traffic, to the benefit of both the mines in West Virginia and Pennsylvania and to the ultimate benefit of the consumer.

The DOT plan to preserve competition by spinning off lines to small regional rail carriers is not a new idea. It has been tried before and failed. Regional railroads identified as possible operators of the spun-off portions of the merged Norfolk Southern-Conrail system posted operating losses for 1983—or 1984, and are highly marginal. The two class I railroads, the Delaware & Hudson and the Boston & Maine, which are part of Guilford Transportation Industries, are good examples.

Guilford is a company which was approved by the DOT as a buyer of NS-Conrail properties to enhance competition. The D&H liabilities were almost one and one-half times its assets at the end of 1983. The D&H reported a net loss, I believe, of $16 million for 1983 and something more for 1984. The B&M posted a small net income in 1984 of $8 million on revenues of nearly $125 million.

The P&LE has had a series of operating losses over the past years, and in 1984 it lost $11 million.

Certainly these smaller railroads are simply not strong enough, either financially, physically, or marketing-wise, to support the service demanded. Shippers, consumers, and taxpayers will pay the price.

A Norfolk Southern takeover of Conrail may have a net cash benefit perhaps in as little as 5 years to Norfolk Southern of hundreds of millions of dollars more than the $1.2 billion Norfolk Southern price just as a result of tax breaks. The reason is that Conrail's tax benefits that are not foregone in the sales process will shield Norfolk Southern's earnings.

To sum up, 4 years ago the Department of Transportation took the position that Conrail could not survive as an independent railroad and should be split up. Conrail and its employees put a plan together, presented it to this Congress and said: We believe we can do it; give us a chance and we will make Conrail a viable, profitable company.

The Congress gave Conrail that chance, and I believe the results speak for themselves. Once again, 4 years later, we believe our proposal can succeed. What we ask is what we asked 4 years ago—the opportunity to prove it. If we get that opportunity, I believe the critics will go the way they went in 1981.

Thank you very much.

The **Chairman**. Mr. Crane, thank you very much.

Recently there has been a trend toward a decline in total freight tonnage on Conrail. Do you anticipate that that decline will continue in future years?

Mr. **Crane**. All I can say, Senator, Mr. Chairman, is the fact that the business has leveled out beginning in 1983. It seems to have gone up a little bit in 1984. Our corporate plan would believe that it would be level in 1985. Our economists, maybe incorrectly, foresee a rather deep recession in 1986, where it would drop down. They then forecast that the tonnage level would continue to rise and be back at the 1984-85 level by 1987-88.

I think that, let me say, that the shrinkage in industrial capacity in the Northeast has pretty well bottomed out. We still have at least 35 percent of the total productive capacity of the country in that area. We serve that area, and I think that at our present level of traffic we will be able to sustain that over the next several years.

The **Chairman**. You would see it as pretty flat in the next several years?

Mr. **Crane**. That is correct, sir.

The **Chairman**. Yesterday, Mr. Claytor testified that if Norfolk Southern ends up owning Conrail he would like you to stay on with the company in a special position, for which you would not be disqualified by reason of the standard retirement age.

I would hope that if Norfolk Southern ends up owning Conrail you would accept that offer and lend to Conrail your continued advice. I am sure that it may be premature to ask you that question, but I am expressing the hope for whatever comment you would care to make.

Mr. **Crane**. The only comment I would make, Mr. Chairman, was that I have had no discussions with Mr. Claytor on that point.

The **Chairman**. Thank you.

Senator Hollings.

Senator HOLLINGS. Let me add—thank you, Mr. Chairman—Mr. Crane, to what our chairman has noted. The country is indebted to you. You have done an outstanding job. That is why it is so viable and attractive an acquisition for Norfolk Southern and some of the other bidders.

It just so happens I have to agree with Secretary Dole that the best one of all of them without question is the Norfolk Southern bid. Now, with respect to that bid and the continued service which concerns us all, Norfolk Southern has gone into detail as to how with the merger they can even perform a better service. You look at some of the evidence, and you find a diminution of only about 1,250 employees, and that only by attrition, in the plans.

Is there any other evidence that you as an old railroad man can give the committee that would indicate that that service would not continue?

Mr. CRANE. I guess my answer to that, Senator Hollings, would be that I think, for one thing, there is going to be a substantially greater reduction in employees than 1,250, as has been presented by the Norfolk Southern. I would suggest to you that, despite their statements, which have not been specific, you do not need two accounting departments, you do not need two treasury departments, you do not need a duplicate of many administrative functions, and that all of the people involved in those functions will disappear.

Now, we anticipate that of the 4,000 people we have in Philadelphia, fully 2,000 of them right there would be gone. I do not think there is any question about that. I do not know how quickly that would occur, but I think it would occur fairly quickly.

Indeed, if you look at the record of the Norfolk & Western and the Southern Railway, when those two companies got together their employment diminished very substantially over the next 4- to 5-year period of time. I would think that a prudent management on Norfolk Southern would do the same thing.

Now, with respect to the service responsibility, obviously, let us say, if the shipper has the option of two competing carriers he is much better off than if he has the option of only a single carrier. And the single carrier, because of the fact that he has some monopoly position, can impose on the shipper what would be most efficient for him from an operating standpoint, but which might not be most serviceable to the shipper.

Therefore I would anticipate, and I expect some of the shippers will, that there would be some diminution in service as a result of that.

Senator HOLLINGS. Well, on the issue of the diminution of employees we have looked at that closely. Of course, that is one of the reasons we are complimenting you, I guess, because you were able to draw down from 100,000 to 38,000. Some 62,000 have lost their jobs during your particular administration. So that is not necessarily bad, is it?

Mr. CRANE. Let me correct your figures, Senator. There were 100,000 people when Conrail was formed. When I came freight employees there were about 63,000. Today there are 39,000. But that is not necessarily bad, I agree with you. It is simply a statement of fact.

Senator HOLLINGS. Right.

With respect to the covenants, are there any covenants that you as a railroad man think should have been obtained by Secretary Dole that were not obtained in this agreement with Norfolk Southern, I do not know railroads; you do. What would be another protection in the public interest that might have been obtained that we should look at closely?

Mr. CRANE. Well, let me say that I would be the last one to suggest to you that there would be covenants. I perceive covenants as an effort to control the decision of management with respect to the optimum operation of the company. I do not advocate the presence of the covenants even if Norfolk Southern were the successful bidder.

Senator HOLLINGS. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Mr. Crane, one of the matters that has come to my attention is that you all are either investing or have completed investment in the development of a railroad line spur to a particular coal mine in West Virginia, at the expenditure I think of some $10 million to yourselves, for the purposes of servicing Detroit Edison.

Now, I spent 3 or 4 years as Governor of West Virginia fighting that whole effort, along with the United Auto Workers and the United Mine Workers and others in Michigan, because it just so happened that the Governor of Michigan did not fill out his appointments on the Air Pollution Control Commission, and the Air Pollution Control Commission voted by a 5-to-4 vote, which is very close obviously, to lower the sulfur content of the coal that could be burned at this particular Detroit Edison unit.

So we in West Virginia have been trying for quite a long time to find a way to regain the potential 3-million-ton market, which as you know is several thousand jobs for coal people, not just others involved in the shipping. Now, you have come along and are in the process of doing this or have made this investment, together, I would guess, with Bethlehem and some operators.

That really solves a big problem for us, because your spur would approach a mine that would produce lower sulfur coal, and that lower sulfur coal would be attractive to Detroit Edison as I understand it, and therefore would be a very substantial benefit not only for railroad people but also for coal miners.

Do I have my facts correct on that?

Mr. CRANE. You are absolutely correct about that, Senator. One of our difficulties on Conrail has been, as a result of the environmental emissions requirements in the Midwest, some of our principal public utility customers need to have lower sulfur coal than is available on Conrail on Pennsylvania sources.

Our principal source of low sulfur coal is in West Virginia, as you know. However, we have very few locations down there. Most of them are served by competing railroads, either NS or CSX.

In our particular case, in an effort to improve our competitive position marketingwise, which is the reason why I think we need an independent Conrail, we have reduced our prices from our origin points of low-sulfur coal as compared to Norfolk Southern's origin locations for low-sulfur coal going to points in the Northeast and Midwest.

Our problem has been that we have not had adequate supplies there. When Detroit Edison was required to meet these emission requirements, we were providing them with about 4 million tons of high-sulfur coal which they had to transfer to low-sulfur coal. We did not have that coal on our railroad.

Bethlehem Steel decided to develop some properties they had on the very bottom of our line going from Columbus down to Charlestown and on to Swiss, WV, on the NF&G Railroad, and we will serve that line with a branch going up to it.

We hope by the end of this year to be transporting a million tons out of that mine. I believe that Detroit Edison hopes to expand their requirements. And in order to be sure that we could serve that mine, we have made something like about a $35 million investment in our track, to provide welded heavyweight rail all the way from Columbus down to Swiss and on to the NF&G points, and we are looking forward to that with a great deal of interest.

I must say that, with many other sources of low-sulfur coal on Norfolk Southern, I would seriously doubt if they would continue to market strongly the production of the High Power Mountain project.

Senator ROCKEFELLER. That was the followup I wanted to come to. I did not want to sound like I threw you a softball to hit out of the park, because I am as yet undetermined as to how I am going to vote on all of this.

But it does seem to me that it should be put into the record, for all those who do not follow these matters closely, that Conrail has been exceptional in its performance on what I would call one of West Virginia's, and indeed Appalachia's, largest problems, and that is trying to keep rail rates down. And I think in fact it could be fairly said that Conrail has done a better job than the other two competitors in the area.

Now, I cannot say why that is, but I can say that it hints at something which is good for the future. And as I pointed out yesterday, I think there are two kinds of potential job losses which people are talking about in all of this. One is, you know, if we do such-and-such or such-and-such, what about the railroad jobs, and that is very important.

But there is another aspect too, and that is the overall growth in the economy in the region affected. And of course, in our case a lot of that has to do with coal and all the jobs which feed back and forth on each other related to that industry.

So can you explain to me why it would be in your judgment that if this merger were to be consummated that Norfolk Southern would not be inclined in your judgment to take advantage of what looks like a good deal with respect to Detroit Edison and West Virginia?

Mr. CRANE. I think they would be inclined to take advantage of Detroit Edison, by increasing the price out of the Swiss, WV, location commensurate with their price for transportation from other low-sulfur locations on the railroad.

Let me say, that is one of the competitive things that we have forced in there. When you do not have the business, you are ready to compete for it. When you have got a lock on the business, you do not have to compete for it.

Senator **Rockefeller**. Thank you.

The **Chairman**. Senator Ford.

Senator **Ford**. Thank you, Mr. Chairman.

Just two quick questions. You said—and I have been pouring over your statement and I hope I heard you right, and if not, I want you to correct me—that your economists have indicated to you that there would be a deep recession in 1986?

Mr. **Crane**. That is correct, sir.

Senator **Ford**. Will it be as deep as the one in 1982?

Mr. **Crane**. The prediction that our economists made was that it will be as deep as 1982.

Senator **Ford**. We may not have to worry about the employees, then, whether they have a job or not.

Mr. **Crane**. Let me say, one of the unique things about Conrail, Senator Ford, is the fact that, unlike other companies, our plans for the future are a matter of public record. They are required to be that way by the U.S. Railway Administration.

We have filed that plan. There will be some temporary reduction in employment in the year of 1986 commensurate with the reduction in economic activity. Nevertheless, we predict a profit of about $300 million in that year, while sustaining a capital program of somewhere around $400 million.

We think business will come back after that and then our employment again will increase at that point in time.

Senator **Ford**. How much tax does Conrail pay?

Mr. **Crane**. How much tax?

Senator **Ford**. Yes.

Mr. **Crane**. Can I ask Mr. R.H. Platt, who is sitting on my right, our executive vice president of finance, to try to answer that question.

Senator **Ford**. He is dressed like a vice president, too.

Mr. **Platt**. Thank you, Senator.

The answer to the question is, I presume you are talking about Federal tax?

Senator **Ford**. Federal, State, local—all of it.

Mr. **Platt**. Conrail does not pay Federal tax and has had no reason to because its net operating losses and the investment tax credits since inception, 1976, have not made it necessary to pay taxes in the profitable years.

We have been exempt from certain State taxes and the aggregate of those, the value is about $25 to $30 million a year. We do pay other State taxes in considerable amount. I think that is in the order of $40 million.

Senator **Ford**. What are the other State taxes that you are talking about?

Mr. **Platt**. Those are local taxes, Senator, by cities, counties, communities of various types. The only ones we were exempt from was the State taxes under the Northeast Rail Service Act.

Senator **Ford**. And all Federal taxes?

Mr. **Platt**. No, sir; we were not exempt from Federal taxes.

Senator **Ford**. Well, you are in effect exempt since you have had such losses, and we have backed you up to the point that we appropriated funds. Then you took your tax loss and carried that forward so you would not have to pay any taxes, and that gave you an improved financial statement.

Mr. PLATT. Oh, yes, sir; we agree with that. And it is quite obvious that in this proposal, whichever conclusion is reached, everyone has agreed to give up the net operating losses and the investment tax credits that were accumulated since 1976.

Senator FORD. What is the accumulated tax credit for Conrail that would be given up by the final owner?

Mr. PLATT. Well, after we file our 1984 return the net operating loss figure will be between $1.8 and $1.9 billion, and the investment tax credit is about $275 million.

Senator FORD. So somewhere in excess of $2 billion will be given up, which the Government will acquire indirectly in taxes.

Mr. PLATT. That is correct, Senator. Of course, it has been our view, and I think that of everybody involved in the process, that to have taken money at the front end, in the early period of Conrail when we were generating losses, and to take the benefit of those taxes afterwards was double dipping. So I do not think anybody seriously entertained maintaining those.

Senator FORD. Let me ask, Mr. Crane: you reduced the number of employees after you arrived from 60,000 down to 38,000 or 39,000?

Mr. CRANE. That is correct, sir.

Senator FORD. So we are talking about somewhere in the neighborhood of 25,000 to 28,000 employees. How did you arrange for that reduction? What benefit did the employees receive as a result of their elimination?

Mr. CRANE. Well, let me go back just a bit in history. At the time that Conrail was formed under the terms of the RRR Act, employee protection was written into that act which had the effect of guaranteeing everybody who had seniority on Conrail their jobs until age 65. I think that is a simplified explanation.

Obviously, as the reduction in traffic and revenues available to the company occurred from 1976 on through 1980 and 1981, when traffic was continuing to go down, and 1982, why, there simply was not enough revenue coming in from the available business to support that type of payroll. But the management was unable to make the reductions because we were directed by the Congress to keep the people on the payroll.

At the time the Northeast Rail Service Act was passed, that problem was identified. The Congress provided two techniques to ease the transition of those people. The first technique was to permit us to buy out certain train and engine service employees, at which time, as I recall, they would be reimbursed to the amount of $25,000 a person and they were permitted to retire with retirement benefits if they had qualified for them at that time and that was financed by the Federal Government.

The other people who were released in that period of time were permitted to take a one-time buyout of $20,000 per person, with the provision that they renounce their seniority, or if they did not want to do that, in addition to their normal unemployment compensation which they would receive, they would also receive some $41 and some odd cents a day until the $20,000 had been consumed. That program also was financed by the Federal Government.

Now, the combination of those two programs did much to relieve the unemployment and the hardship that was forced on some of those people by the reduction in manpower at that time.

Senator FORD. Mr. Chairman, may I ask one other brief question, please? You say that most of the reduction in employees, as I gleaned from your statement, reading between the lines, would be administrative.

Mr. CRANE. Oh, no, no, excuse me.

Senator FORD. You said you did not need two Treasury Departments and so on.

Mr. CRANE. I said that, but I also would suggest to you that if the Norfolk Southern combination occurs, that there probably will be the same number of trains run over the railroad, so I would not anticipate a large reduction in train and engine service employees, but I would expect a substantial reduction in mechanical employees who maintain and inspect cars, the electrical employees who maintain electrical equipment, and clerical employees because they will combine yard offices and yard clerical help in many of the duplicate locations which we have, and so I would expect that there would be a substantial reduction in people in that area.

Following my testimony, Senator, I believe that some of the labor people may be here, and I would suspect if you asked that question of them, they would be able to give you a corroborative answer on the same basis. I have heard estimates of as many as 8,000 jobs lost, certainly at a minimum some 4,000 jobs lost, not including the people that I talked about in Philadelphia.

Senator FORD. Is there a provision in the proposal to do basically the same thing for those 4,000 to 8,000 employees that you were able to do for your 30,000 employees?

Mr. CRANE. Let me say I am not sure of that. The Norfolk Southern talks about offering them New York dock job protection agreement, which would be protection for 6 years, but I am not sure that that is applicable to the people initially.

It may be applicable to them after the merger is consumated, but the force reductions might be made in an interim period. I would suggest that if you have the opportunity, you ask the Norfolk Southern, the labor people, because I am not familiar with that.

Senator FORD. The only problem you have with that would be if they are removed from their positions in an interim period before the final act—a certain period of time for transition.

The transition period would catch these people, and they would be laid off. We might have to then say that during any time from the time this is approved until the final takeover, labor protection would apply. We would have to be very careful if we included that New York provision.

I thank you, Mr. Crane. You have been very helpful. And I thank the chairman.

Senator PRESSLER [presiding]. According to the list given me, in the order of arrival, Senators Gorton and Kasten, who are not here, would be next, and Senator Riegle, according to this list.

Senator RIEGLE. Thank you, Mr. Chairman.

Mr. CRANE, I want to thank you publicly, as I have done privately, for the outstanding public service job that you have rendered, I think, to the country. There is a lot of talk about incompetence in

Government, and there is a lot of it. Buying $600 toilet seats over at the Pentagon—somebody is not doing their job right there.

But it seems to me you have taken a very difficult situation, and with a good team you have made a lot of progress, and I think you have a right to be proud, and I think you have a right to have that good work acknowledged.

I appreciate it, the people in my State appreciate it, and I think the people in this country who take the time to look at the Conrail issue are also appreciative. You come in with that kind of record of performance, and I think that gives the weight of—that gives much additional weight to the testimony that you offer to the committee.

I want to ask you a couple of blunt questions. You have been very forthright, and I would like just blunt answers. First if we are going to go through with a private sale, is this price adequate? Is the price that is being talked about here in your view a reasonable price, a fair price, a low price, a high price?

I have a real question about that in my mind, and I would just like your candid, independent assessment of the question of the value and what we are talking about here, and to relate that value to the price that is on the table.

Mr. **Crane**. Senator Riegle, I can only give you a personal opinion. I do not consider myself a qualified financial man. People have expressed surprise that all bidders came in with about the same price, which is unusual, it would seem, if you really had competitive bidding.

I could only say that I think the price, if anything, is somewhat low. As other witnesses have pointed out, with the amount of cash we have, with the amount of cash available that we have out of the plan with the scrap value of the company it looks like a low price.

On the other hand, the Department of Transportation has decided that they want to move forward promptly with it. There are witnesses who have suggested that perhaps if you waited a while longer, and the company continued to perform as strongly as it is now, that you might get a better price for it, or if you made offerings of it in a series of offerings, as they are doing in some of the British privatizations, rather than demanding that it be done at one point in time, you might get a larger price.

There will be investment bankers here today, and I expect they would be better qualified than I to be able to answer that, but if you ask my opinion, I think the price is too low.

Senator **Riegle**. Well, that is an important question, and it seems to me that to try to get to an answer requires a balance of opinion, not only from investment bankers, who are very useful people to try to assess this, but I think in many respects from you, who may be in as good a position as anybody to try to think through the question of how we might value the assets in this kind of an enterprise.

Now, as I understand it, you have over $800 million in the cash drawer. Is that correct?

Mr. **Crane**. That is correct, sir.

Senator **Riegle**. And the price that is being talked about here is in the neighborhood of $1.2 billion. There are different ways to define that, but that is generally what is thought to be the price being offered. Is that correct?

Mr. **Crane**. That is correct, Senator Riegle.

Senator **Riegle**. Absent everything else—and there are questions about how different kinds of tax items might be treated—it seems to me that if I am buying something for $1.2 billion, and in the process of buying it I am picking up $800 million in cash, that cash is an offset to the $1.2 billion, and I am really paying $400 million for whatever it is that I am buying in addition to the cash.

Now, when I look at what else it is that is being purchased here in addition to the cash—the properties, rolling stock, the business in place, what good will there is, customer relationships, et cetera—I try to understand what is there in addition to the cash. Give me, if you can, a brief sort of summary description of the entity apart from the cash for which essentially the $400 million is being paid.

Mr. **Crane**. Well, it is difficult, Senator, to come up with a number of that type. As we said, as we wrote Senator Specter, if you took what Conrail owned, and some of our locomotives and cars are leased, and we do not own them, but if you took what we owned, and you sold it for the current value of scrap, in other words, you cut up all the locomotives and cars, you took up all the track and cut up all the track, you sold the underlying property for the average of what we have sold that underlying property for in connection with the line abandonments that we have made, we came up with a number of over $3 billion just for the scrap value of the company.

Now, certainly businessmen talk about the going concern value of the company. Sometimes you use a multiple of the company's earnings to come to that. I understand that the current railway multiples are somewhere between six times and eight times.

Even if you took Conrail's $500 million of earnings this year and discounted it by the $60 million for the wages that might be paid to our employees at the lower level that they forewent in the first part of the year, because the $500 million included a charge against the P&L statement for the $60 million from July 1, 1984, to December 1, 1984. Otherwise, we would have reported earnings of $560 million for the year.

So, the point is, I take 60 off of that and I get down to 440. I take taxes off of that, which, let us say, would be 100, I get down to 340. I take State value out of that, State taxes for another 30, I get down to 310. I multiply the 310 by a 6-figure, and I certainly get up to $1.8 billion. If I multiply it by an 8-figure, I get up to around $2.4 billion.

Senator **Riegle**. And that is having the $800 million in the cash drawer to the side.

Mr. **Crane**. That is correct.

Senator **Riegle**. Obviously, there is a difference between selling a going concern where the intention is to maintain it as a going concern and to try to value a future earnings stream and everything that connects to that, and the scrap value or the liquidation value if you tear up the tracks and take it down to the junkyard and so forth.

But I am struck by the fact that the liquidation value is in the range of the figure that you speak of, since some estimates would put it as high as—I gather you said nearly $3 billion, or on that order.

We are talking about a lot of value here, if we value it in terms of that kind of a measure of residual value, or then, of course, it is a matter of judgment if you are going to try to do it from the point of view of a going concern as to how you value a future earnings stream.

The more I listen, and the more I have had conversations and studied this issue, the more I think we have got a very valuable set of assets here, and I am, too, a little quizzical about why it is that the bids that have come in have been so close.

Some might say that, well, it just shows that there is a consensus as to what the outside value is. I am not sure if that is the case or not. I have seen a number of other instances where the administration has wanted to sell off, if you will, public assets—Comsat being one example, oil leases offshore being another example, coal leases yet another.

And what has happened in some of those cases is that we have found that in the rush to unload assets to generate quick cash—you might say a bird in the hand to put against this massive and burgeoning Federal deficit, a question has been raised in all of these instances as to whether or not we are selling assets too cheaply and are going to end up in a situation with a public concern about how those assets are finally utilized and how the value from those assets is distributed and whether or not the public interest is being properly served in the divestiture of a public asset.

I think those questions are here. Now, I sense that there is a real rush to get this done. In other words, suddenly it is like a full court press. It is like watching the Harlem Globetrotters move the ball around the basketball floor in a desire to consummate this deal.

Now, maybe it is the thing to do. I am not sure whether it is or is not. As I said yesterday, my mind is still open on it, and it is still open on it, but I think the question of establishing the value here is a very important question.

I do not take that separate and apart from the question of service and convenience. I have a lot of customers in Michigan that I want to continue to see serviced by these lines, whatever the ownership structure is, but it seems to me the question of a fair price is a very important question.

It is important to everybody in this country, because at the present time this asset belongs to the people. It does not belong to the administration or to the Commerce Committee or to the Senate or to you or to anybody else. It belongs to the people of the country, and I think we have to be certain that they are getting full value in terms of whatever disposition takes place.

The other question I would like to have you answer—and I heard the bell ring and thought I got a quick bell—with as blunt an answer as you can give us as to what you see as the hookers in the Norfolk Southern deal. Obviously, you have a point of view. You have stated it very frankly today.

But when you look at the package as it is on the table in terms of where the fishhooks are that we ought to be concerned about from the broad view of the public interest, the broad view of the future, the broad view of maintaining service and so forth, what are the aspects of that package that as a professional, in your own personal opinion, give you pause?

What are the aspects that are troubling to you, or where you feel that much careful looking and weighing have to be done in terms of those aspects of this offer or package as it sits on the table today?

Mr. CRANE. I think overwhelmingly the most important aspect of it, Senator Riegle, is the matter of competition. There are three railroads in the Northeast now, three large railroads in the Northeast, Conrail, CSX, and Norfolk Southern. There are three major railroads in the West now, Southern Pacific-Santa Fe, Burlington Northern, and Union Pacific-MP.

You have a balance between the East and the West, and when you do away with, when you fold Norfolk Southern and Conrail together, you are going to disturb that balance, and you are going to seriously disturb the overall competitive aspects of rail service east and west, and I think that that is dreadfully important, and that overwhelmingly above everything else is my consideration.

Jobs are important. The price paid is important. The covenants may be important. But above everything else, it is a matter of competition for the shipper, and I submit to you that Conrail has been in the leadership role under the Staggers Act provisions to be competitive with its pricing and to provide the best possible price transportation service to the customers in the territory it serves. That will be diminished unquestionably when one competitor leaves.

Senator RIEGLE. Well, my time is up. I think it is important for you to give us in addition the next level of answers to that point you have just mentioned—in other words, to try to reach further into that question of the competitiveness that would remain if this deal were done—the damage to competition that you see is what I think we need to understand more fully.

I would like you now, if the Chair would oblige, or before you leave the table, to give a more complete exposition to us of what you think that competitive loss or damage would be if we go to two carriers on the east side of the country, what the long-term implications are, and how they relate to the public interest and the transportation requirements of the country by rail as you see them.

I think if that is the No. 1 issue, then let us open it up and get it out on the table here.

Mr. CRANE. Do you want me to take the time to do that now? That is a very extensive thing to respond to.

Senator RIEGLE. If that is the No. 1 issue, we had better understand it, because you are not going to get another time at bat. If that is the issue, let us get it out in the open so we can digest it.

Mr. CRANE. Well, there is no question the Justice Department themselves in their analysis has clearly indicated that the acquisition of Conrail by the Norfolk Southern will eliminate interrailroad competition between Conrail and Norfolk Southern at a very large number of locations, and when you eliminate that competition, obviously, under the freedoms of pricing which we enjoy at the present time, the remaining carrier has within certain constraints the right to decide what price he wants to put on.

Now, Norfolk Southern has talked about opening up rates and routes. We have never closed routes on Conrail, as a matter of fact. What we have done is to attempt to price our most efficient routes in the most competitive manner, which is what any business would do. I would suggest to you that when there is duplication, there is competition.

When there is only one person to serve, there is simply no competition. And I would suggest to you that there are many locations on Conrail which are jointly served by Norfolk Southern and Conrail which, when Conrail disappears, the competition will disappear there, and as a result the price competition will disappear there.

I have identified some 500 million dollars' worth of railroad rail revenue that we have been able to identify as being directly competitive, and I would suggest to you that the shipper may well pay that premium price when he does not have an alternate railroad to force the other railroad to compete against.

And let me say that is the overwhelming problem. We will not get into the fact of whether the price is too low or the asset is so much better. It is simply a fact that the competition will not be there.

Senator RIEGLE. I do not want to transgress the right of the committee to record my time on this. I would like you, however, to elaborate for the record any other thoughts that you have on this competitive problem, as you see it.

Mr. CRANE. We will provide a memorandum to you, Senator, on that specific matter. I would be delighted to do that, and I thank you for the opportunity.

Senator RIEGLE. Thank you, Mr. Chairman.

Senator PRESSLER. I would like to ask a couple of questions regarding the public offering first, and then have a followup on that divestiture question.

Do you believe that a stand-alone Conrail with a public offering would be as strong financially as Conrail would be in combination with Norfolk Southern? And I ask that in the context that I understand you were recently quoted in the New York Times as questioning the management performance of the Norfolk Southern after your departure.

Do you have, or do you think this committee should have reservations about their management capacity?

Mr. CRANE. Well, you put me on the spot, Senator, but I have never been one to dodge an issue. And I guess I will not dodge it now. I would suggest to you that when my predecessor, Graham Claytor, was president of the Southern, and when I was fortunate enough to succeed him, one of the objectives we had in that company was a continued increase in our profitability over a period of time, even in the very bad year of 1975, we had a very modest increase in profits. It was not much, but it was a little bit.

I would point out to you that, let me say Norfolk Southern has had 2 down years from the peak of profits they reached in 1981, the down year of 1982 and the down year of 1983, and I would suggest to you that I have not seen any figures put together by anyone which would indicate what they expect the combined profitability of Conrail and the Norfolk Southern to be.

Senator Hollings has pointed out that in testimony yesterday Norfolk Southern said they had $1.5 billion, and I have only got a paltry $850 million. I understand that. But I would suggest to you that I am not so sure that the combination of the two railroads is going to be such an all-fired success.

Senator **Pressler**. If Morgan Stanley, who I understand is your investment banker, believes that public offering is feasible, why have not this or other investment bankers given Secretary Dole a firm commitment to underwrite a plan?

Mr. **Crane**. That is a good question. I guess you will have to ask Morgan Stanley that when they come here, and I do not want to second guess them. I think they are attempting to move forward in that area to line up the necessary investors so that they will be prepared to make their guarantee.

It is a big commitment on their part. If the lead underwriter says, I am going to produce $1.2 billion, what he does is guarantee that that is going to come out of their pocket if they do not sell it.

Now, as big as Morgan is, they cannot by themselves guarantee that amount. They have to form some sort of a syndicate and share that among other people. I will let them speak for themselves when they testify about what their plans may be, Senator——

Senator **Pressler**. Good. I will ask them. Let me follow Senator Riegle's question again in terms of if there were two carriers left, how that would affect railroads in other parts of the country, especially in the midwest, on this divestiture issue.

Now, I have asked the Antitrust Division to give us some analysis of what the results will be when it shakes down to midwestern railroads. I am thinking of, in particular, the Chicago and North Western, the Burlington Northern, the Soo Milwaukee. What would be the spinoff effect in your judgment?

Mr. **Crane**. I think, let me say, if nothing else you may find diversion of traffic via Norfolk Southern as compared to Conrail in those and there will be areas I would not anticipate that the grain drawn from that area would move to the North Atlantic Ports of Baltimore and Philadelphia as compared to the South Atlantic ports and the Gulf ports that are served by Norfolk Southern.

It is difficult for me to focus on Soo Line Milwaukee. I would suggest to you that there is a strong possibility that the volume of chemical traffic being generated on the Missouri Pacific Railroad which normally moves to the Chicago and St. Louis gateways might move over Norfolk Southern over the New Orleans gateway for the longer movement on the Norfolk Southern itself, and indeed perhaps a more efficient movement.

I would expect that there would be further diversions of business of that type, and the management would be foolish not to take advantage of those.

Senator **Pressler**. Senator Hollings?

Senator **Hollings**. Thank you, Mr. Chairman.

Mr. Crane, what have you told Morgan Stanley about the continuation of management at Conrail. What plans are there for your successor?

Mr. **Crane**. Let me say there is no problem there as far as I am concerned, Senator Hollings. As I have said to everyone so many times, I am somewhat embarrassed by the accolades presented to me with respect to the performance of Conrail.

I am very proud of the fact that when I went up there I did not take a single person from Southern Railway with me, not even a personal secretary. I did not go out and hire anyone. I found on Conrail all the management talent that was necessary along with its employees and their motivation to turn this company around.

We have a broad spectrum of people on Conrail, including my president, one executive vice president, two senior vice presidents, and six or seven other vice presidents. From that array of officers, when the time comes for my successor, it will be picked by our board of directors in the same manner that a successor is picked by other companies.

Indeed, I guess I would have to say I do not know what is going to happen on the Norfolk Southern when Bob Claytor steps down. It may well be that Harold Hall will be the next president. It may be that there are other people in the organization that the board will decide are the important people.

But I can assure you, Senator Hollings, that there is ample talent on that railroad in-house to continue the successful operation of Conrail by selecting one of those people as the lead manager.

Senator HOLLINGS. Good. In other words, if we had a public offering, and management would be an important part of that offering, I could look either to you or your successors from the particular board that you have there now, the officers you have there now.

Why is it, Mr. Crane, that those who participated, and vigorously, over quite a period of time with money and time and effort, like Bill Marriott and Allegheny and the others, right down to the bottom line—with your estimation of about $1.8 billion to $2.4 billion—why did they not come up $100 million and kick up at least to $3 billion for scrap? Why did they not, if they really wanted Conrail, according to your estimation, make a higher offer?

Mr. CRANE. I cannot answer that, Senator. I am not capable of doing that.

Senator HOLLINGS. Thank you, Mr. Chairman.

Senator PRESSLER. Thank you. I believe that concludes this panel. I thank the witnesses very much.

Mr. CRANE. Thank you, Mr. Chairman. I thank the members of the committee very much for the opportunity and the courtesy to appear before you. We do appreciate it. Believe me.

Senator PRESSLER. Thank you very much.

[The statement follows:]

STATEMENT OF L. STANLEY CRANE, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CONSOLIDATED RAIL CORP.

Good morning, Mr. Chairman and members of the committee. Thank you for this opportunity to discuss Conrail's vital importance as a transportation company for the nation.

Today I'd like to address four areas:

1) Conrail management's proposal for a public offering of stock to return the company to the private sector;

2) Conrail's new labor agreements with 15 of its unions to return their members to industry-scale wage levels;

3) The DOT proposal for a Norfolk Southern acquisition of Conrail, and why it will be destructive to competition.

4) Huge tax benefits to NS as a consequence of a possible takeover of Conrail.

Let me begin by telling you why we think the public offering approach is best.

First, we believe an independent Conrail, with independent management and an independent Board of Directors accountable to a broad base of stockholders, has the greatest incentive to serve the long term interests of shippers and communities, and to demonstrate a willingness to make the investments and commitments required to maintain quality service.

The public stock offering approach to return Conrail to the private sector ensures such a corporate structure, and will permit Conrail to be managed for long-term financial viability.

I submit to you that the record of Conrail over the last four years provides the foundation for the case on behalf of the public offering. The strength of Conrail today is the result of significant contributions made by Conrail employees. Both management and union workers cooperated to make Conrail a strong, viable and efficient railroad. That cooperation, extended into the future, is one of the principal reasons the level of confidence in the success of Conrail can be so high.

The reason I emphasize the confidence in Conrail's future is that attacks on the public offering usually begin by questioning the long term financial viability of the company. So long as management working with its union employees has the flexibility to meet the demands of the marketplace and can respond to the economic cycles like any other company, there should be no concern for the future. The Department of Transportation would have you believe they have "guaranteed" the future by imposing restrictive five year covenants, just long enough to get by the next presidential election. No one can "covenant" traffic and revenue levels. And while the public offering proposal can meet those covenants, it would be a serious mistake to rely on those covenants as providing any security for Conrail over the longer term. They do not, nor can any set of covenants ever do it. The future is best secured by maintaining the kind of management/labor cooperation and determination to succeed that has been developed over the last few years.

But, Mr. Chairman, if you want confirmation of my views about the future of Conrail, why not ask some of the other bidders? While I am only slightly less enthusiastic about the NS than I was about the other bidders, I submit to you that their offers indicate the high degree of confidence in the investor marketplace in the future of Conrail. Mr. Chairman, I don't believe either Bill Marriott or Fred Kirby are the kind of people who would risk their own money or their company's resources in an enterprise whose future is clouded with great uncertainty.

We believe that because the nation's taxpayers financed the rebuilding of Conrail, it is only fair and equitable that the taxpayers now be permitted to participate in -- and benefit from -- Conrail's future success, by investing in Conrail stock, just as they now invest in thousands of other industrial corporations, including every other large railroad in the country.

We also believe that Conrail employees should be recognized in a concrete manner for their significant contributions to Conrail's success. Our public offering proposal does exactly that, by keeping 30 percent of Conrail's stock in employees' hands. That stock and the dividends it could earn represent a direct financial interest which employees would have in helping to keep the company financially successful for the long term.

The DOT's financial adviser, Goldman Sachs, has questioned the feasibility of a public stock offering, but they don't state that it cannot be done. And there is no secret why they don't - it can be done. Our financial adviser, Morgan Stanley, stated in a January 28 letter to me that: "....the high level of unsolicited inquiries which we have received from a number of large financial institutions demonstrates the soundness of our conclusion that there is an enormous investor appetite for Conrail equity securities."

We keep hearing that what is contemplated in the public offering is too much for the market to absorb. The example of the Ford Motor public offering in 1956 is most often used to question the feasibility of a Conrail public offering.

Unfortunately, but not surprisingly, those who try to make the argument don't put it in context. All of us would agree the world has changed since 1956 when the Ford offer was made and one of the changes has been considerable economic growth. The $658 million public offering for Ford represented 0.3% of the total value of the common stock listed on the New York Stock Exchange in 1956. A public offering representing 0.3% of that same value in 1985 would be $4 billion. Arguments that there isn't enough capacity in the stock market for a Conrail public stock offering simply cannot be supported by the facts.

Because there have been concerns that someone, now unknown, might try to gain control of Conrail through a public offering, a 10% limitation on ownership for any one company, concern, or individual was suggested. It is nearly identical to the Comsat limitation. Much to my amazement, I now hear that this limitation is "weakness" in the public offering proposal because it would insulate management from the discipline of the marketplace. Mr. Chairman, all I can say is that if you accept that statement you are stating that every major railroad has the same insulation. There isn't a stock concentration of over 10% in any major railroad today.

Next, I find the public proposal under attack because it would use up to $300 million of Conrail cash to accomplish. Yes, it's true - the proposal we made would use $300 million of Conrail's cash, but the NS proposal provides for $375 million to go to Conrail employees, all of which can be Conrail's cash, except for the amount used for the ESOP buy-out. In other words, Norfolk Southern can use Conrail's cash for anything it wants except the ESOP buyout. So that means the cost of the return to industry level wages for our employees retroactive to July 1, 1984, as well as labor protection and other labor costs, can be paid by NS from Conrail cash.

Recent testimony by the Department of Transportation would have you believe that the public offering plan violates the DOT covenants because over a five-year period there would be over $400 million in borrowings. These borrowings have absolutely nothing to do with the sale of Conrail, no matter who the purchaser is. These borrowings are for equipment acquisitions which Conrail will need regardless of the identity of its owner. If the Department of Transportation is suggesting that the Norfolk Southern would not be doing this kind of equipment financing, it seems to me that the one's worst fears about continued investment in plant and equipment would be confirmed.

To sum up, we strongly believe that a public offering of stock is in the best interests of our constituencies and the nation.

As evidence of Conrail's restored financial vigor, Conrail has reached a significant agreement with 15 of its labor unions. We would hope that the two remaining unions will become signatories in the very near future. The agreement returns Conrail's union employees to rail industry wage levels, retroactive to July 1, 1984. Because of the company's strong financial condition, we could afford to take this important step in recognition of employees' past contributions.

Now, let me turn to Conrail's shippers, and why they are so supportive of an independent Conrail. In my view, it is because such a company would preserve the Northeast-Midwest rail system. Shippers in the Northeast and Midwest have been patient for a long time. They were the ones who suffered most directly from the collapse of the Penn Central and the early years of Conrail. They had to put up with deteriorating service and noncompetitive rates. Today, for the first time in many years, they have a system that works; in fact, in a Distribution magazine survey, shippers voted Conrail the best railroad in the country in 1984. Conrail knows how to compete for their business, and Conrail has made a long-term commitment to helping them stay in business.

Scores of Conrail shippers have communicated to us and to government officials their satisfaction with the excellent service provided by Conrail and their opposition to Conrail's acquisition by Norfolk Southern. Most recently, in testimony before Senator Frank Lautenberg (D-N.J.) in New York City on February 25, four of our customers -- United Parcel Service, Union Camp, American Cyanamid, and Witco Chemical -- all testified to the high quality of Conrail service and the highly competitive transportation company Conrail has become. Not one of them expressed anything but the greatest concerns over an NS takeover of Conrail, and all four cited the public offering plan as near or at the top of their lists as the way to return Conrail to private sector ownership.

An NS takeover means starting the process all over again: dismantling the system; setting new marketing strategies; reducing the commitment to industry in Conrail's service territory; and most of all, eliminating the competition that is fundamentally responsible for the high quality of service and competitive rates that Conrail shippers have come to count on.

Let me tell you how substantial the head-to-head competition currently is between Conrail and NS. Conrail traffic competing with the NS at origin, destination, or both, is worth more than $500 million a year in rail revenue. Conrail and NS compete vigorously for that traffic. As a result, shippers, receivers, and consumers benefit. A takeover of Conrail by NS means a total loss of that type of competition, and a real loss to our shippers in dollars and cents.

There is another aspect of competition between Conrail and NS, called geographic competition, where the railroads are not running side by side, but rather compete because their customers compete. Let me give you some examples of how Conrail's very existence stimulates geographic competition.

Norfolk Southern and Conrail serve competing coal fields in West Virginia and Pennsylvania respectively, which are desirable sources for coal-fired utilities in New England. When Conrail offered a more attractive rate for coal, the utility pressured NS to reduce rates also. NS adamantly refused to change its rate initially, but then the forces of the marketplace took over. The utility used public forums to suggest that it would buy the more-competitive coal from the Conrail-served mines. The NS-served mine announced that if it lost the coal contract, hundreds of jobs would be lost and the mine might have to close. State officials and others who viewed the NS actions as anticompetitive exerted pressure on NS, forcing Norfolk Southern to establish a more-competitive rate. In fact, by being an aggressive competitor, Conrail continued to participate in a portion of the coal traffic, to the benefit of mines in both West Virginia and Pennslyvania, and to the ultimate benefit of consumers.

In another instance, one of our major shippers wanted to open a new coal mine to serve a major Midwestern utility -- a power company. That company was receiving most of its low-sulfur coal from mines in Kentucky and West Virginia located on other railroads. Conrail wanted to compete for the company's business and we wanted our shipper's new low-sulfur coal mine in West Virginia to succeed. The result is that a new railroad connection is being built to serve the mine. Conrail cut its rates to make coal from the new mine competitive. The utility will buy coal from this mine. Conrail will transport it. If Conrail were owned by NS, which serves the mines in Kentucky and West Virginia, this might never have happened. Why would NS cut rates without Conrail's competition? Why would NS spend money to build track to a new mine when it already served others? Without Conrail's competition, the ultimate consumers of electric power would have suffered.

There are many examples of Conrail acting as an advocate for the industries located in its territory, and making special efforts to allow those industries to compete with their rivals located on the lines of other railroads. There are examples in the coal market, the chemicals market, and the steel market. In fact, for almost every commodity we move, Conrail rate initiatives enable our shippers to expand their marketing opportunities, their operations, and their profits.

The Department of Justice report did not even attempt to address this kind of competition. In fact, the Department's "quick fix" to lessen the anticompetitive impact of the proposed sale would do nothing to remedy the loss of geographic competition. Moreover, the Department of Justice scheme to remedy the loss of head-to-head competition -- spinning off part of the merged system to smaller railroads -- will not work. It's not a new idea. It was tried before and it failed.

With the creation of Conrail in 1976, the United States Railway Association granted the Delaware & Hudson Railway extensive trackage rights over the Conrail system to enable it to connect with the Norfolk and Western Railway at Buffalo, NY and the Southern Railway, Chessie System and Richmond, Fredericksburg and Potomac Railroad at Washington, D.C. The objective was to provide for added rail competition in the Northeast.

Instead, what was created was an uneconomical rail operation that in 1983 required the Delaware & Hudson to spend $1.05 in operating expenses for each $1.00 in revenues generated, and a company -- the D&H -- whose liabilities were almost one-and-a-half times its assets at the end of 1983. The D&H reported a net loss of $16.3 million for 1983. I might note that the D&H is one of two Class I railroads which are components of Guilford Transportation Industries the same company which was "approved" by the DOT as a buyer of NS/Conrail properties to enhance competition. The other Class I railroad component of Guilford Industries is the Boston & Maine Railroad, which posted a small net income in 1983 of $3.2 million on revenues of nearly $60.1 million. The B&M's liabilities of $69.8 million equal nearly 65 percent of its assets.

Similarly, other regional railroads, identified as possible operators of the yet-to-be spun-off portions of a merged NS/Conrail system, operated in the red in 1983. The Pittsburgh & Lake Erie falls into that category. In 1983, P&LE reported a net loss of almost $23.5 million on revenue of $43.2 million. Its overall liabilities equalled 88 percent of its total assets.

Because of the financial instability of these smaller railroads, shippers and taxpayers have paid the price -- through inefficient operations. These smaller roads are simply not strong enough to support the service demanded. Shippers, consumers, and taxpayers will pay the price again.

Kevin T. Dowd, who testified on behalf of the Eastern Coal Conference at Pennsylvania Senator Arlen Specter's recent hearing to examine the anticompetitive aspects of a Norfolk Southern takeover of Conrail, observed objectively:

"The competitive influence that is exerted by Conrail is made possible by its size, independence, and the location of its lines as the main source of rail deliveries to the Northeast. One could not make up for the loss of a single, consolidated major competitor simply by granting trackage rights and gateway access to a number of small, regional carriers that lack the physical capacity -- even under the best of circumstances -- to go toe-to-toe with the CSX and Norfolk Southern Systems." A great many Conrail shippers have communicated similar views both to the DOT and to us in support of a public offering.

Finally, I need not remind you that Conrail is a leading advocate for competition in the railroad industry. While other railroads have only begun to adapt to a deregulated environment, Conrail immediately seized the opportunities presented by deregulation to become more competitive and responsive to shipper needs. We were the first railroad to withdraw from the rate bureaus where all rail rates had been set collusively for more than a century. We're still the only railroad to have done so. It seems incredible to us now that with all the railroads and the different places served by each, there was no competition between them. Those days are gone now, because Conrail sets its prices the way they are set in other businesses -- competitively. We still lead the industry in fighting for another right that most businesses take for granted -- the right of rail carriers to set their own prices on their portion of multi-carrier movements.

These initiatives have been controversial, and have been resisted by those railroads who like the old ways of doing business, but they meet the needs of our customers, and therefore, they have been successful in the marketplace.

Conrail's net income between 1980 and 1984 improved by approximately $745 million, even in the face of the serious recession that occurred in the middle of those years. The Northeast-Midwest rail system works because Conrail has made it work. Many have sacrificed to make it happen and to restore a company others perceived as lost, financially and as an entity. To subject the nation again to the high degree of uncertainty and trauma that would surely result from an NS takeover of Conrail would undo all the progress we have made.

I wish to mention one other aspect of the Norfolk Southern takeover plan for Conrail which bears close scrutiny of the Congress. The Department of Transportation, in making its selection of the NS to acquire Conrail, stated that it was "based solely on who would best serve the interests of the public...and give the taxpayers the best rate of return possible" consistent with other criteria.

On close examination, there are a number of financial benefits and tax breaks which the Norfolk Southern would receive as a result of an acquisition of Conrail. Thanks to those financial benefits and tax breaks, it is conceivable that when all is said and done, a Norfolk Southern takeover of Conrail will have a net cash benefit to Norfolk Southern, perhaps in as little as five years, of hundreds of millions of dollars more than the $1.2 billion Norfolk Southern will pay for Conrail! Is that in the best interests of the taxpayers? The Department of Transportation says it is, because it advocates an NS takeover of Conrail.

That is not the main issue here, of course. The main issue is what is best for the transportation infrastructure of the country and competition and jobs.

But it is amazing to me that a formerly broken-down railroad system, for which the government paid some $1.8 billion (to the predecessor railroads), is being sold for some $1.2 billion, and the buyer stands to not only recover all of the price he will pay for it, but make money on the deal! If you desire, we can provide specific data on this matter.

I might note that the Treasury Department representative who testified yesterday stated that there is no special treatment of Norfolk Southern involving its future income tax benefits as a result of an acquisition of Conrail by Norfolk Southern. That's accurate. But is it the best deal for the Federal Government and for the United States Treasury? The answer is no, because -- simply put -- a public offering will bring the Treasury a greater return in future taxes, paid by separate Conrail and Norfolk Southern Companies, than will a sale of Conrail to Norfolk Southern. And the same will be true at State levels.

Mr. Chairman, stripping everything away, I believe the basics of this argument over how to sell Conrail really come down to the future of the company. Why do I say that? Because when you look at the arguments being raised against the public offering, the only one that would prompt you to reject it and support Norfolk Southern is the one that Conrail has no long term future. All the other arguments fall by the wayside and are no more than weak attempts to discredit a strong plan.

I believe the debate on the sale of Conrail is at the same time a referendum on whether or not it has a long term future. If it has a long term future - as I so firmly believe it does - the reasons for the private sale disappear completely as does the rationale for all of the covenants.

Parenthetically, I've always believed there were only two possible reasons for the covenants: either you didn't trust the buyer; or you didn't have confidence in Conrail's future.

Over the last few years we have finally achieved a truly consolidated company with all of the effects of combining six railroads into one wrung out of the system, the development of a true feeling of teamwork between management and labor, and a real sense of pride in the record and accomplishments.

I wish to point out that four years ago this same Department of Transportation said Conrail couldn't make it, would be a drain on the U.S. taxpayers and should be split up and sold off in pieces. That prescription was wrong then. The prescription DOT offers four years later is wrong, too.

There's an old saying - "If it's not broke, why fix it". Conrail's not broke. It's doing just fine. What DOT has suggested is unneeded major surgery that carries with it large costs in terms of reduced employment, service and competition. My question to the Congress is - with respect, Mr. Chairman - whether or not those costs should be imposed on communities, shippers and employees when there is another answer?

Thank you. I await your questions.

Senator PRESSLER. I shall now call forward the investment banker panel, consisting of Mr. Thomas Saunders III, Mr. John S. Guest of Lehman Bros., Mr. James M. Voytko of Paine Webber, and Mr. Kenneth Brody of Goldman, Sachs & Co.

I shall call on Mr. Thomas Saunders, managing director, Morgan Stanley & Co., for his testimony, and we are under the—I understand we hope to be under the approximate 5-minute rule, although if you have something overwhelmingly urgent to say, continue on.

All of your statements will be in the record, incidentally.

STATEMENTS OF THOMAS SAUNDERS III, MANAGING DIRECTOR, MORGAN STANLEY & CO., INC., ACCOMPANIED BY JAMES A. RUNDE, MANAGING DIRECTOR; JOHN S. GUEST, ADVISORY DIRECTOR, LEHMAN BROS.; JAMES M. VOYTKO, FIRST VICE PRESIDENT, PAINE WEBBER, INC.; AND KENNETH D. BRODY, PARTNER, GOLDMAN, SACHS & CO.

Mr. SAUNDERS. Thank you, Mr. Chairman.

I appreciate the opportunity to appear before this committee today, and to comment on the privatization of Conrail.

Throughout Morgan Stanley's recent involvement with Conrail, there are several questions which we have been asked repeatedly by Conrail's board, by its management, and by certain Members of Congress.

What is the market value of Conrail? Is a privatization of Conrail which embodies a public offering feasible and doable? Could such a public offering or a series of public offerings be structured to meet the convenants proposed by DOT?

Perhaps most importantly, after such a privatization, would Conrail be viable as an independent, free-standing railroad basically in its present form? Could a group of investors be assembled to make a firm proposal which satisfies DOT's requirement that the government be free of any market risk if that be necessary?

In effect, could the Government be taken out of its 85 percent interest in Conrail on a day certain at a specific price?

We would like to share our thoughts on these questions with you today. I would like to point out that we have not been advocating a public sale of Conrail as the only way to return the company to the private sector, nor are we here today to say that.

We are saying, however, that the public offering alternative should be given a fair hearing in the full light of day and carefully examined on the business merits. Furthermore, now that there is a clarity with respect to the Norfolk Southern alternative, we would ask that a comparison of the public offering and Norfolk Southern be made.

The basis of such comparison should include the amount and timing of proceeds, antitrust considerations, obviously the maintenance of service and implications for labor, long-term liability, and obviously implications for the entire U.S. rail system.

We would suggest that upon a close examination, that the public offering will show up very well. As of yet we have seen no evidence of close scrutiny by anyone of the real or net proceeds to the taxpayers and the true cost to Norfolk Southern of the Conrail franchise.

For example, Norfolk Southern will be able to consolidate Conrail for tax purposes, shelter taxes on non-Conrail income, thus effectively reducing the proceeds to the government.

The true cost to Norfolk Southern of buying Conrail will almost certainly be less than $1.2 billion, due to the potential for realizing proceeds from the sale of short lines and tracking rights, access to Conrail's cash balances, and access to the overfunded pension fund.

It is hard to see that Norfolk Southern transaction optimizes proceeds to the U.S. taxpayer.

Now, to value. In June 1984, for the purposes of the board of Conrail, we valued 100 percent of Conrail as $1.6 to $1.7 billion. The comparable value today is $2.0 to $2.2 billion. That is for 100 percent of Conrail.

This is not to suggest that we have raised our valuation to give the appearance that the public offering is more competitive today than last June. In fact, a number of changes have taken place in the marketplace that would suggest this reevaluation upwards.

Since we have given our views, the stockmarket has hit an all-time high and continues to trade near that level. Interest rates have fallen significantly since last June. The outlook for the general economy has improved somewhat, and in fact there is almost a consensus as to a different outlook than was held last year.

Since early last December, just this past December, PE multiples of eastern roads, Norfolk Southern and CSX, that is the principal measure for valuing stocks in our marketplace today, have risen 20 percent, from 6.6 times to 7.9 or 8 times.

Overall, railroad multiples have increased from 7.9 to 9.6 times. The receptivity to large equity offerings this year is running much stronger than it was in 1984. Conrail's results have also come through. The 1984 results exceeded the budget. The 1985 budgeted earnings look strong in our view. The cash position of $845 million at year end is significantly higher than projected.

We have also done our analysis looking at earnings that included restoration of wages to industry levels, provision for labor protection, full payment of State taxes and Federal income taxes, and foregone interest on reduced cash balances.

Given that current valuation and these market considerations, we believe that a public offering transaction could generate net proceeds of $1.5 billion and possibly more for the government's 85 percent interest in Conrail.

By way of comparison, and using an identical analysis, Norfolk Southern's offer of approximately $1.2 billion would imply a multiple of 3.5 times compared to the Eastern roads' 7.9 or 8 times. There is no question in our mind that we can produce a plan for the issuance of all equity providing proceeds in the area of this $1.5 billion, and on one day, if necessary.

If I can just take another couple of moments, I will pass over some of these other points. I would like to address the question of convenants. Let me say that a public offering can be structured to meet the covenants as outlined by DOT.

Even if we use Conrail's conservative financial projections, and I make the point that the built-in 1986 recession is probably now disputed by many economists, and if we use capital expenditures that exceed DOT's minimum requirements by $800 to $900 million, we can still meet the covenants.

This approach, in our view, does provide the necessary flexibility to meet the dividend cash and capital expenditure requirements. Having said that, we would suggest that the covenants are appropriate to ensure certain desired management behavior in a private sale are not appropriate, and they are unprecedented for a Conrail that would be held by the general public in a broad shareholder group.

In fact, to burden a publicly held Conrail with arbitrary covenants may well lead to a less than optimal capital structure and unnecessarily encroaches upon management's prerogatives.

In closing, I would make two points. Some people have questioned the ability of the Government to tap the U.S. capital markets to effect this transaction. Many people have missed the point of the recent British Telecom offering. I personally worked on that offering throughout most of 1983 and 1984, and the real point about British Telecom is a measure of market capacity. It is not a question of comparing the technology of that company or its competitive position to a cyclical railroad. It is a question, if you have priced a security and discounted it as that was done, can you build market capacity to absorb an offering of the size of Conrail?

When all is said and done, with all of the comments about British Telecom, no one can refute the fact that the British Government raised over $4 million one day in a London market. That represents 7 percent of the world's equity markets. The U.S. equity market is 56 percent of the world's capacity.

And finally, we are prepared to put together a firm proposal made of the most blue chip investors with whom we are in present discussions when we can satisfy such a group of underwriters and investors that we are not putting them through an exercise that may well tie up and waste their capital and personnel resources.

Thank you very much, Mr. Chairman.

Senator PRESSLER. Thank you. I now call on Mr. Guest of Lehman Bros.

Mr. GUEST. Good afternoon, Mr. Chairman, Senators.

My last appearance before this committee was some years ago in support of an application for a guarantee of a $100 million loan to the trustees of Penn Central Transportation Co. A loan was granted, and $100 million was gone within a few months. It was spent.

I say this just to point out that in the railroad business, as investors well know, cash can build up very fast and it can go down very fast.

Over the following 6 years I worked with the trustees of Penn Central. I saw them cutting their maintenance, juggling their payables in order to make the Friday paydays. Finally, they came to the end, and the Government had to take it over, and that is where Conrail was created.

Now, Conrail now has a new name, new management, and a new profit loss account, but I submit to you, Mr. Chairman, that the profit loss account, as we say, pro forma, under private ownership is an untested hypothesis. We have seen what it can do with Government aid. We have not seen what it can do without Government crutches.

Now, could Conrail, and this is what I have been advising our clients, the Norfolk Southern, could Conrail be acquired by Norfolk Southern without becoming a burden upon Norfolk Southern itself at this price and with these covenants that are being accepted by Norfolk Southern.

We have analyzed this for the management and the board of the railroad, and we are satisfied that the synergy and efficiencies that were referred to by Mr. Claytor yesterday and the financial strength which has been accumulated by prudent financial management should enable them to carry Conrail with the covenants and without impairing Norfolk Southern's financial credibility.

The price offered is close to $1.6 billion for the property, $1.2 billion plus some extra cash from the Government, $375 million in hard cash or stock if they want it for the 15 percent interest owned by the ESOP. We are satisfied that by industry standards of railroad stocks that is not too high, but it certainly is not a steal.

Now, I wish to refer a little bit to the proposals for a public offering. The proposal by Senator Heinz, I have not seen the analysis of it, but in my judgment, this is what we call in Wall Street a best efforts offering, where somebody says, I will do the marketing for you, but I will not underwrite the price.

Now, that tells the investor something about the merchandise that is being offered. It raises a question in people's minds as to why nobody was willing to underwrite it, so Senator Heinz' plan I would feel is perhaps not a feasible option to be considered.

With regard to the plan that my friend on my left is proposing, all I have to say is, I have not seen anything in black and white on this, whereas the Norfolk Southern thing is a document which has been signed. It is in ink. It is not words or promises.

The question on covenants, which has been accepted by Norfolk Southern, and which I am sure that the promoters would much rather not have in order to sell the stock, from the seller's point of view, gentlemen, I would say the covenants on somebody that has no financial backing beyond what he is buying should be tougher rather than lighter.

Norfolk Southern can comply with the covenants because they have the money to do it. I am not certain about the independent group.

The dividends that have been referred to, the heavy commitment, all in all, gentlemen, I do see the risk of another Penn Central being sold to the unsuspecting public and more responsibility of the U.S. Government as the seller, possibly even a legal liability under the securities laws, and the people I see suffering, not only the general public but also the employees who at the moment own 15 percent of the stock and are being asked to acquire another 15 percent for the ESOP. That is, they are putting their jobs and their savings at risk.

I believe that that is all I have to say.

[The statement follows:]

STATEMENT OF JOHN S. GUEST, ADVISORY DIRECTOR, SHEARSON LEHMAN BROS.

INTRODUCTION

Overview

I am John S. Guest, an Advisory Director of Shearson Lehman Brothers. During my career in the investment banking field, which I began in 1937 with Kuhn, Loeb & Co. (one of the predecessor firms of Shearson Lehman Brothers), I have devoted a considerable amount of my time as a specialist in the railroad industry, assisting the Firm's railroad clients. During the past 15 years, I have served as an advisor to Southern Railway Company (a predecessor of Norfolk Southern Corporation ("NS" or the "Company")), the Trustees of Penn Central Transportation Co. and Erie-Lackawanna Railway Company and continue to be an advisor to the Trustee of Milwaukee Railroad Estate. I have also provided financial advice from time to time to The Pittsburgh and Lake Erie Railroad Co., Grand Trunk Corporation, Guilford Transportation Co., the Missouri-Kansas-Texas Railroad Company, Texas Mexican Railway and Fruit Growers Express Company.

Shearson Lehman Brothers has been directly involved in the process of the Conrail sale as financial advisors to NS, prior to and since May 10, 1984 when the United States of America published notice in the Federal Register soliciting offers from any and all parties interested in purchasing the United States' interest in the Common Stock of Conrail.

Shearson Lehman Brothers, one of the nation's leading investment banking firms, is well qualified in the fields of general corporate finance, valuation analysis and the securities markets. As it relates to this transaction, we have particular stengths in both the equity markets and in the area of mergers and acquisitions. During 1983 and 1984, we lead managed (i.e. had primary responsibility for) 48 initial public offerings totalling more than $1 billion and 71 common stock offerings totalling more than $2 billion. From 1980-1984, we have acted as financial advisors on more merger and acquisition transactions than any other investment banking firm.

In our capacity as financial advisors to NS, we have undertaken a comprehensive review of Conrail, together with the sale process itself in order to enable us to express our views on a variety of issues surrounding the proposed sale of Conrail.

Methodology

To form our conclusions, we undertook many analyses, the data for which are summarized in this testimony but are available to any member of the Senate Commerce Committee, or the staff of such Committee member, who desires to review such detailed material. Our analysis included, but was not limited to, the following:

- (i) A review of market and financial data of comparable railroad companies as well as other cyclical and capital intensive industry groups, including the automotive, steel and petrochemical industries;
- (ii) A review of values paid in other recent railroad merger transactions;
- (iii) A review of the other offers submitted by parties interested in acquiring Conrail;
- (iv) An analysis of the viability of and inherent risks in proceeding with an initial public offering of Conrail;
- (v) Comparative analyses of the financial viability and strength of Conrail in combination with NS and as an independent entity under an initial public offering scenario, as proposed by Conrail management and
- (vi) The ability of Conrail under each scenario, as defined in (v) above, to meet the various covenants mandated by the U.S. Government in the sale of its interest in Conrail.

Conclusions

The following conclusions represent the views of Shearson Lehman Brothers, as investment bankers, and are supported by the data included in our review.

(i) NS has offered a fair and reasonable value for the 85% ownership interest in Conrail currently held by the United States of America. Our views are substantiated by analyzing:

- Price to earnings multiples accorded comparable rails and other comparable industry groups,
- Prices paid in other recent railroad acquisitions and
- A number of other qualitative issues such as the size and financial integrity of NS, the commitment of NS to abide by the restrictive covenants mandated by the U.S. Government and the representations the Company has made to the Conrail employees.

(ii) An initial public offering of Conrail, in general, and as specifically proposed by the Conrail management, is not in the best interests of the U.S. Government. This proposal does not meet the very guidelines and objectives established by the U.S. Government, exposes the U.S. Government to a measure of uncertainty as to the total proceeds to be realized in the sale (bearing in mind the firm commitment of NS to pay $1.2 billion plus any cash on Conrail's books in excess of $800 million) and does not guarantee the future financial stability and viability of Conrail (particularly when contrasted with a pro forma NS/Conrail combination).

(iii) Combining Conrail with NS creates a very viable railroad company with significant financial resources, the ability to weather the most severe of recessions, the capacity to satisfy the U.S. Government's restrictive covenants, extremely able and experienced management and preserves the interests of shippers, labor and the areas served by Conrail. The financial profile of Conrail under the privatization plan, quite simply stated, does not provide for these results.

VALUATION OF NS OFFER

Introduction

Central to the decision facing any seller is the selection of the method which maximizes the value received in the sale process. The U.S. Government is undertaking a deliberate review of two alternatives: a private sale transaction and a sale to the public, or an initial public offering. Many experts have expounded on their views that the public stock market is a perfect market with respect to the establishment of fair values for publicly-traded securities of corporations - a market in which a true auction takes place and where willing buyers and willing sellers establish values on an arm's-length basis. With our experience in the securities and investment banking industry, we would endorse this view. This view combined with our experience in valuation analyses leads us to the conclusion that the creation of a valuation model for Conrail will dictate the maximum value that would be accorded the Common Stock of Conrail in a public offering.

We have undertaken to create such a valuation model for Conrail and have determined that NS' offer is fair and reasonable in light of this valuation model. It is also our view that the stock market should accord no greater value to Conrail than that value which we have derived for and ascribed to Conrail. We would therefore conclude that the U.S. Government will not receive any greater proceeds from an initial public offering of Conrail than from the proposed private sale to NS. Further, were the investing public to perceive a degree of uncertainty (and we believe that this would occur) with respect to Conrail's future (as compared with that of comparable companies in the railroad industry), Conrail's shares as initially priced and offered in the stock market would be accorded a discount from actual values in order to compensate the investor for this additional risk. In addition, with the requirement that a company operate with certain restrictive covenants (as the Government has proposed Conrail be required to meet), a further discount would be applied to actual values were the public to perceive these covenants as a potential constraint on management's flexibility to make decisions in the best interests of the company and its stockholders (and we believe that this would occur also).

NS has offered approximately $1.6 billion cash for 100% of the Common Stock of Conrail of which approximately $1.2 billion represents proceeds to be received by the U.S. Government with the balance payable to the employees. In contrast the Conrail management plan proposes to offer $1.4 billion to the U.S. Government for its ownership interest in Conrail and to issue additional Conrail common stock to the employees. The fundamental differences between the two offers are created by (i) the substantially different financial condition as measured by the utilization of $300 million of Conrail's cash to finance the purchase under the Conrail management plan, (ii) the shifting of risk to the employees of Conrail as the new Conrail stockholders and (iii) the uncertainties associated with the actual proceeds to be raised by the promoters in an initial public offering ($500 million in common stock and $600 million in preferred). The hard cash committed by NS to the Conrail acquisition is $1.6 billion on a firm basis. In contrast, the promoters would be seeking to raise $1.1 billion in a public offering where the outcome is far from certain.

The NS offer is in the best interests of the Government, the public taxpayers and the employees. It is our view that a private sale to NS, as recommended by the Department of Transportation, represents a permanent, stable and safe solution whereas Conrail, under Conrail management's plan, does not have the financial strength or resources available to it as a stand-alone entity that it would have as part of NS. To the contrary, the Conrail management plan jeopardizes the future of the enterprise by saddling it with an onerous burden of dividend commitments and reducing its financial security through the payment of $300 million of Conrail's cash to the U.S. Government, as seller.

Below, we have substantiated NS' offer in light of our valuation analysis.

Introduction and Discussion of Offer

NS' offer for Conrail can be analyzed from a number of perspectives. The Company has offered to pay the United States cash totalling $1.2 billion plus cash on Conrail's books in excess of $800 million. With regard to labor's 15% ownership interest, NS has offered to pay $375 million in cash as well as to provide a number of other benefits. Including NS' offer to labor, the Company has agreed to pay a total purchase price of approximately $1.6 billion.

While this figure represents the total value paid by NS to acquire 100% of the Common Stock of Conrail, there are additional obligations which the Company has agreed to assume and which can be quantified to provide an indication of the total value offered by or, stated differently, the total cost of the acquisition, as expressed in net present value terms, to NS. The value of these obligations totals approximately $4.0 billion bringing the total value of the NS offer to approximately $5.6 billion. These obligations include, among others, an agreement by NS to comply with certain covenants stipulated by the U.S. Government (e.g. capital expenditure requirements) as well as certain concessions provided to labor (e.g. elimination of wage concessions, New York Dock protection and other job loss protection).

In addition, it is our view that a number of qualitative issues relating to NS as a purchaser of Conrail bear mentioning. The U.S. Government has mandated that the sale of Conrail maximize the return to the tax payer and also that Conrail be assured of a strong, financially viable future preserving the optimum level of service to Conrail shippers. Currently, NS has assets totalling $8.6 billion, a total book value of $4.5 billion, cash and marketable securities totalling $1.1 billion and revenues and net income for the most recent fiscal year end (December 31, 1984) were $3.5 billion and $482 million, respectively. NS' senior unsecured debt is rated AA/Aa2 by Standard & Poor's and Moody's, respectively, and the Company remains committed to the railroad industry as it has been for well in excess of 100 years.

In addition to the prospect of Conrail joining with such a financially sound entity, NS has agreed to a number of conditions and can clearly demonstrate that it has the financial wherewithal to fulfill such agreements, all of which serve to satisfy further the U.S. Government's objectives in the sale of Conrail. The Company has agreed to:

(i) Continue Conrail's business substantially as it is now (subject to the divestitures mandated by the U.S. Department of Justice) and maintain a controlling interest for a period of five years; NS will operate Conrail as a total system and will not break it up or sell off parts;

(ii) Make capital expenditures at specified levels and maintain maximum standards on equipment and track maintenance; NS is widely regarded as having one of the highest operating and maintenance standards in the industry;

(iii) Limit dividends on Conrail common or preferred stock unless a minimum cash balance of $500 million would remain after such payment;

(iv) Relinquish Conrail's special authority to abandon unwanted rail lines and offer abandoned lines to shippers or short-line railroads at 75% of net liquidation value;

(v) Maintain Conrail's headquarters offices in Philadelphia;

(vi) Maintain and continue all existing Conrail agreements with shippers and

(vii) Comply with a recommended divestiture plan as set forth by the Department of Justice which will ensure, and in some cases enhance, existing levels of competition in the regions served by Conrail.

The Company has also committed to a number of improved benefits for the employees of Conrail. The $375 million in cash offered to the employees, when combined with the financial strength of NS today (and a new NS/Conrail combination), maximizes the employees' value of their ownership interest and their prospects for long-term job security. While any employees whose jobs are eliminated as a result of the merger are granted very liberal severance benefits, it deserves mentioning that normal levels of employee attrition within Conrail and NS will be able to account for the projected personnel efficiencies within less than one year's time, suggesting that the fears of massive layoffs are unfounded. In addition we understand that these efficiencies are spread throughout the Conrail system and are not concentrated in one office or area.

Fairness of NS Offer As Measured By Alternative Valuation Parameters

In determing the fairness of NS' offer for Conrail, a number of valuation parameters should be used. One must begin by noting that the sale process itself leads to the conclusion that NS' offer is fair and reasonable. Over 100 companies were initially given the opportunity to indicate an interest in acquiring Conrail, and during the course of the review and bidding process, none of the final bids submitted in June, 1984 was in excess of that submitted by the Company. A true auction process, as was conducted by the Department of Transportation with the assistance of Goldman, Sachs & Co., by definition will allow a seller to realize the highest possible price because a large number of interested buyers will participate.

As a secondary confirmation of fairness, we compared NS' offer using the following methodologies, in each case concluding that NS' offer represented a fair valuation for Conrail.

(i) Price/earnings ("P/E") multiples accorded comparable railroads in the stock market,

(ii) P/E multiples accorded other cyclical, capital intensive industry groups in the stock market,

(iii) Valuation parameters for other railroad acquisitions and

(iv) Other bids submitted.

We have excluded from our comparative analysis a measurement of value involving a liquidation of assets scenario. The U.S. Government mandated that Conrail be maintained as an operating entity in substantially the same form as it is today. This requirement, therefore, precludes the development of the potential "break-up" value of Conrail and necessitates an analysis based on the ongoing earnings and cash flow potential of Conrail. The term "break-up" value implies a liquidation of a company's assets (and subsequent discharging of liabilities) whereby the seller can realize more for the individual asset components than if the asset base were left intact. Simply stated, the sum of the parts would be worth more than the whole. By definition the term also implies a substantial change in, if not the total elimination of, the business activities of the entity as of its liquidation. In this light, however, it is interesting to note that those bidders who initially were suspected of having interest in Conrail due to its inherent asset value (i.e. the Marriott Group and Citicorp, among others) submitted bids that were no greater than or, in most instances, lower than the NS offer.

Analysis of Comparable Railroads

As a framework for comparing Conrail to other railroads, we developed a normalized level of pre-tax and after-tax income using Conrail's latest twelve months' reported earnings.

Because Conrail's historical earnings level is of little or no value in projecting future results and due to the cyclicality inherent in the railroad industry, it is valid to attempt to normalize Conrail's average earnings levels over a specific time horizon. For this purpose, we used projections which Conrail management has made and which are included in the Conrail Privatization Plan dated January 2, 1985. We assumed that these numbers would be subject to revision, but they do serve as an accurate barometer of Conrail management's best estimate of the Company's potential earnings stream.

Further, it should be noted that Conrail's projections are subject to detailed scrutiny. While Conrail management has done an admirable job of rectifying many of the problems which have historically limited the company's ability to generate a reasonable level of earnings, the quality of Conrail's future earnings is untested and any projections need to be viewed in light of this uncertainty.

Our analysis indicated that across all valuation scenarios, in which we applied comparable rails' historical and projected P/E multiples to Conrail's historical and projected earnings levels, the NS offer is fair and reasonable. It is important to point out as well that we used P/E ratios accorded railroads with proven records and with high quality of earnings when compared with Conrail. Due to the uncertainty of Conrail's future earnings, it could be argued convincingly that a discount from current market multiples for rail stocks is appropriate, further confirming the fairness of NS' offer.

Analysis of Other Cyclical, Capital Intensive Industry Groups

To confirm further the fairness of NS' offer, a valuation of Conrail can be viewed in light of P/E multiples accorded other cyclical, capital intensive industry groups. We analyzed the automotive, steel and petrochemical industries to provide a framework for this methodology. As was the case with the rail industry, we found it most relevant to use multiples accorded companies over a period of time in order to remove the distortions of year to year earnings fluctuations and to smooth earnings through cyclical highs and lows. For instance:

(i) The automotive industry, in general, sustained large losses in the 1980-1982 period. The 1983, 1984 and projected 1985 earnings picture for the industry as a whole represents the normalized earnings potential and is the most reasonable time period to analyze when according market P/E's to each company.

(ii) The steel industry sustained large losses during 1982-1983 and during 1984 only two of the six companies in our analysis were able to recover to the extent that positive earnings were reported. The period for normalized earnings can be gauged by analyzing 1980, 1981 and the outlook for 1985.

(iii) The petrochemical industry, while experiencing cyclicality, has not experienced quite the severity of such cycles during 1980-1984 as the auto and steel industries and, therefore, the five year historical average and the outlook for 1985 present a reasonable proxy for measuring market P/E's.

Our analysis substantiated that NS' offer for Conrail is fair and reasonable when compared to the normalized P/E's accorded other cyclical, capital intensive industry groups.

Analysis of Other Railroad Acquisitions

We found a third confirmation of fairness to be evident when the NS offer was viewed from the perspective of other recent acquisitions of railroads. When P/E multiples and multiples of book value paid by companies acquiring other railroads were applied to Conrail, conclusions as to the fairness of NS' offer became readily apparent.

We stated above that we have not analyzed Conrail's assets and arrived at a valuation for Conrail assuming Conrail were to be liquidated and its assets sold off. However, the relationship of offering price to stated book value is interesting in light of comparisons that can be made between the NS offer and the Conrail management plan. While there appear to be a variety of ways to calculate Conrail's book value depending on the structure of the transaction and based on the treatment of the Government's forgiveness of certain debt and preferred stock, the two offers can be expressed as a percentage of Conrail's stated book value as of December 31, 1984. As of that date, Conrail's common equity book value totalled $1.1 billion and common and preferred equity book value totalled $3.5 billion. The $1.6 billion NS offer represents approximately 146% and approximately 46% of common equity book value and common and preferred equity book value, respectively, while the $1.4 billion offer under the Conrail management plan represents approximately 127% and approximately 40% of these same book values, respectively.

ANALYSIS OF CONRAIL INITIAL PUBLIC OFFERING

The management of Conrail has put forward a proposal entailing an initial public offering for Conrail as an alternative to the U.S. Department of Transportion's proposal of a private sale of the U.S. Government's ownership interest in Conrail. An initial public offering must be viewed in light of its ability to meet the mandates of the U.S. Government in the overall sale process.

The feasibility of a single-step initial public offering for Conrail as proposed by Conrail management (including $500 million of common stock and $600 million of preferred stock) has and will continue to receive considerable debate from respected investment banking firms which are knowledgable about the circumstances under which such an offering could be successfully, or unsuccessfully, completed. Clearly, the sheer size of the proposed Conrail offering, the fact that we are aware of only one initial public offering sold in the United States in excess of $400 million (Ford Motor Company for $658 million in 1956) and the fact that the fundamentals of Conrail are unclear (Conrail management is projecting a significant decline in pre-tax and after-tax income in 1986 and 1987) all tend to cast a degree of doubt on the feasibility of a successful public offering. While, we would grant that divergent opinions exist on this issue, we do not disagree with the advice of Goldman, Sachs & Co. to the Department of Transportion that many uncertainties exist with respect to the feasibility of a public offering.

Of vital importance in our view, however, are two compelling reasons not to proceed with the public offering alternative, both of which are underscored by the objectives the U.S. Government has stated are of primary concern in the sale process. Specifically, these objectives are (i) to maximize the proceeds by the U.S. Government in the sale process and (ii) to ensure the long-term viability and financial soundness of Conrail. We believe that the public offering provides considerable uncertainty about the total proceeds which the U.S. Government can reasonably expect to receive (particularly when measured against the approximately $1.2 billion firm cash commitment of those bidders in the private sector) and, secondly, that the long-term viability and financial strength of Conrail are far more assured under a private sale transaction than under the public offering scenario.

In analyzing the question of uncertainty the following points deserve consideration:

(i) Current market conditions suggest that investor demand for initial public offerings has significantly diminished from the market environment which prevailed in 1983. Dollar volume of initial public offerings in 1984 showed an approximately 70% decrease from 1983.

(ii) As with any initial public offering, there is a general level of uncertainty as to values which might be realized. An alternative Conrail management plan purports to offer the Government a "firm" commitment of at least $1.2 billion ($200 million less than the otherwise stated $1.4 billion) subject to certain factors. We presume that this alternative plan entails the payment of $300 million of Conrail's cash and $900 million to be raised in the public markets by a group of promoters. The proceeds to be realized from the

Conrail management plan are by no means assured and will not be known until the day the Conrail securities are offered for sale in the public markets as is the customery practice with initial public offerings. While we need to know more about this proposal before commenting further, NS has offered a firm commitment to pay the Government $1.2 billion for its ownership interest.

(iii) To the extent that the covenants mandated by the U.S. Government remain a prerequisite to a sale, it is likely that investor demand will be significantly diminished, further confirming uncertainties as to size and pricing considerations. These covenants create restrictions or limitations on management's ability to make decisions which might otherwise be prudent business decisions and in the best interests of the company and its stockholders. While these covenants are meant to protect Conrail and benefit the continuation of its business activities, there might be circumstances in which compliance will produce the opposite results. If these covenants are perceived as limiting management's control, investor reaction will be negative.

(iv) The ownership profile and limitation provisions are significant to pricing considerations as well. The 30% employee ownership position and the 10% ownership limitation, both suggested by the Conrail management plan, could adversely affect marketability of the stock and could depress the valuation of the issue because the 10% limitation would prevent transactions which might otherwise be desirable (i.e. merging with another company).

(v) As mentioned above, the fundamentals of Conrail are unclear. Conrail appears to be a turnaround situation. However, the future projections of management cause concern as to the ability of Conrail to sustain levels of income reached in 1984. In addition, large projected dividend requirements drain financial resources from the Company which could otherwise be reinvested in productive assets associated with the Company's operations. This in turn could constrain Conrail's ability to continue its dividend policy, causing the loss of an important price support mechanism for Conrail's stock. The receptivity in the marketplace of the "Conrail story" is unclear in light of these facts.

We have also analyzed the price movement (i.e. performance) of recent initial public offerings from the date of each offering until February, 1985. This analysis of aftermarket performance is important as it will provide an indicator of the relative returns available to investors in the stock market from an investment in a portfolio of stocks issued in initial public offerings compared to an investment in a portfolio comprised of stocks of more seasoned companies with a longer history of trading patterns. Aftermarket performance can be analyzed both in terms of the absolute price movement of the security in the stock market after it is priced and sold, and, more importantly, the price movement of the security in the stock market relative to a widely-used indicator of the price performance of the overall stock market. The analysis of the price movement relative to a widely-used indicator will account for the overall stock market environment during the time period under study. The S&P 400 Index is a widely-used measure of overall market performance for 400 industrial companies.

Of the 12 largest initial public offerings completed in 1983 and 1984 seven have underperformed the market from the date of offering through February, 1985, and the average and median underperformance of all 12 offerings as measured against the S&P 400 Index during the same time horizon are (21.3)% and (16.6)%, respectively. Our view is that the U.S. Government should exercise considerable care in allowing the public to hold an attractive security while attempting to limit the potential downside risk to the public. In as much as the U.S. Government will want to avoid future recriminations by the public stockholders who would claim that the U.S. Government had sold the public a "bill of goods", one could argue that a discount from otherwise fair value will have to be allowed in a public offering.

A number of comparisons have been made between the proposed Conrail offering and the recent offering completed for the British Telecommunications. The suggestion that the British Telecom offering is indicative of what is possible for Conrail is not warranted. While in a different industry with a totally different and more appealing story to be told to the marketplace, British Telecom was offered at $5.96 and traded to $11.00 on the very first day of trading, suggesting a conscious effort by the United Kingdom to allow the public to own the stock at a discount from true values. Also accounting for the dramatic price movement were the fundamentals of the U.K. telephone industry and the overall marketing efforts of the offering, all of which serve to suggest that this offering is not analogous to a proposed Conrail initial public offering. The characteristics of the U.K. telephone industry and the freight transportation industry in the Northeast corridor of the U.S. are markedly different. British Telecom also has a virtual monopoly in the growth industry it serves. Conrail has a shrinking traffic base reflecting its location in a low growth territory and intense competition from other transportation alternatives.

Turning to the issue of the financial strength and viability of Conrail in the future, the following points are important to consider.

(i) Management of Conrail has projected significant declines in earnings in 1986 and 1987. Conrail is much more sensitive to the business cycle than other major railroads due to the nature of its service region and its traffic mix. In particular, Conrail's service area, the Northeast, lacks the economic diversity and resilience of those service areas of other major railroads and the region has a long history of bankrupt railroads. Conrail's traffic mix, which includes a high proportion of automotive and steel industry shipments, suffers disproportionately during a recession, and Conrail itself has experienced a long-term decline in traffic volume.

(ii) The Conrail management plan incorporates large amounts of common and preferred dividends. During the 1985-1988 time horizon, management projects in excess of $400 million in dividends. Borrowings increase significantly during the same time period. It is financially imprudent to borrow in order to replenish cash depleted by dividends - a practice that will increasingly constrain the company's financial position, financial flexibility and access to capital markets. Conrail's margin for error under these projections is not as great as might be desired and, in fact, Conrail could be in default of the U.S. Government's restrictive covenants .

(iii) Conrail's financial strength and viability can also be analyzed from a comparative perspective. When comparing the alternatives of a sale to the public and a sale to NS, specifically, it becomes readily evident that a Conrail combined with NS versus a Conrail in the public's hands is a far stronger financial entity when viewed from the financial measurements of credit worthiness, operating margins, returns on equity, cash balances and others. The proposed NS/Conrail combination reflects a company well positioned to weather future recessionary environments and to become even stronger in times of economic prosperity, to remain as a strong well-capitalized entity of investment grade quality and to respond to and fulfill the capital needs of Conrail ensuring high quality maintenance and operating standards. In addition the combined NS/Conrail entity meets all of the restrictive covenants as mandated by the U.S. Government.

In conclusion our view is not only that there is uncertainty with the public offering alternative but, as importantly, the financial viability of Conrail is assured with the private sale alternative allowing the U.S. Government a permanent and stable solution which best serves the interests of Government, employees, shippers and the railroad industry.

Senator PRESSLER. Well, let me out of order here ask Morgan Stanley why have not they or any other investment bankers given Secretary Dole a firm commitment to underwrite a plan? I think that was a point you made. What is the reason for that, since that was a point just made?

Mr. SAUNDERS. Well, Senator, I think that the best way to answer that is in the first place, in a direct request, we have not received such a request to make a firm proposal of that type. By innuendo and in the press, there have been a lot of questions as to where is the public proposal.

I think one has to understand, and I think Mr. Crane stated it quite well, that is a very significant commitment. It is not a commitment that we or another group of investors would take lightly, if we felt that it was productive and was not a waste of time, and a proposal of that nature would receive full and fair analysis compared to any other alternative——

Senator PRESSLER. So Secretary Dole would have to ask you to present such a plan; is that the point?

Mr. SAUNDERS. What I am saying is we were not asked.

Senator PRESSLER. But if she did ask you, you would?

Mr. SAUNDERS. Yes.

Senator PRESSLER. I will save my questions. But if the following two witnesses could address the point that Mr. Guest made about Senator Heinz' plan, as I understand it Senator Heinz says we should make a public offering, and if we don't get enough, then take Norfolk Southern's offer, basically.

And that sounds awfully good to me. But maybe there is a catch to that. In any event, I will now call on Mr. Jim——

Senator RIEGLE. Mr. Chairman, would you yield just briefly? As long as there has been an intervention here, I think it would be useful to have on the record—and perhaps this was done before I entered the room—I think it would be useful if we knew whom each party at the table is representing—if they are, in fact, representing somebody, if they have been retained by somebody at the table.

And I know in at least some instances, that is the case, and perhaps all, but I just think that we ought to have that on the record.

Mr. Guest, I understand, if I have it right from the documents here, that you are representing Norfolk Southern. Is that correct?

Mr. GUEST. That is correct, Senator.

Senator RIEGLE. Mr. Brody, you were here yesterday, of course, but I think it would be good again if we just go right across the table and establish the relationships as to who is representing whom here on a retainer basis.

Would you like to go next here, and then let's go right on down the line.

Mr. BRODY. We are representing the Department of Transportation. We are the financial adviser to the Department of Transportation.

Senator RIEGLE. And on retainer to them?

Mr. BRODY. And on retainer to them.

Senator RIEGLE. So they hired you for that outside service which you have been rendering; is that correct?

Mr. BRODY. As the legislation suggested that they do.

Senator RIEGLE. I am not suggesting that it is not legal and proper. I just want to get the relationships established.

Mr. Saunders?

Mr. SAUNDERS. We were their financial adviser and were hired by the Board of Conrail to advise them with respect to this process. We have completed that assignment and we are no longer retained by the Board. We have been working with management on the further development of the privatization plan.

Senator RIEGLE. So you are not here representing anybody in terms of a client relationship?

Mr. SAUNDERS. We have a client relationship with the management of Conrail; yes.

Senator RIEGLE. So you are still on retainer to them?

Mr. SAUNDERS. In fact, we are not on a retainer to them. We are working with them on a normal investment banking relationship which would not require necessarily a retainer arrangement.

Senator RIEGLE. I understand.

Mr. Rundy?

Mr. RUNDY. I am managing director of Morgan Stanley, and I am with Mr. Saunders, on the same basis.

Mr. VOYTKO. My name is Jim Voytko, and neither I nor my firm are representing any of the parties involved in disposition. The only connection I have at this point is that over the past year or so, I have been representing Norfolk Southern stock, among other stock, to my clients partly on the basis of the Conrail disposition.

Senator RIEGLE. So you have been invited to testify as an interested party.

Mr. VOYTKO. I expect, as an outside party with relatively little at stake, but presumably something to offer the committee. That remains to be seen.

Senator RIEGLE. Thank you, Mr. Chairman.

Senator PRESSLER. Since we have had a slight change of course, I do want to at this point ask my question about Senator Heinz' plan. Isn't this done? Would it be possible if Secretary Dole asked for a public offering, made the request, and got a plan, the public offering were offered, but it didn't get enough takers or however it is done, and if it failed, then take Norfolk Southern's offer?

Why couldn't that be done?

The CHAIRMAN [presiding]. Senator Pressler, I appreciate your filling in for me when I was in Senator Dole's office. It is my understanding that Mr. Saunders and Mr. Guest have testified but that Mr. Voytko and Mr. Brody have not; is that right?

Wouldn't it be appropriate if they testified, and then if we were able to ask everybody some questions, so people would have their time at bat.

Mr. VOYTKO. Let me get straight to the questions that I think are relevant, and I think I might have something to offer.

Is $1.5 to $1.6 billion a fair price for Conrail? I think the answer is probably yes, for the following reasons. If you assume private sector, comparable private sector net income for Conrail in the $200 to $250 million range, the PE that results from that for a highly cyclical company like Conrail, which is lacking in very significant and attractive nonrail assets, at least compared to other railroads, seems reasonable to me.

The second reason is that the presence of covenants, although they may or may not impose future costs on the buyer of Conrail, may reduce its value somewhat, and I think the comments of my colleague from Morgan Stanley and the comments of Mr. Crane earlier suggest that the covenants are a touchy issue.

The third reason—and this has been brought up in the questioning—if the price is too low, far too low, why has no buyer emerged over the extended and very well-publicized bidding process that is prepared to offer more cash for Conrail without burdening the company itself with additional debt and risk?

I can't answer that question, and even Mr. Crane has not been able to.

Is a public offering possible? Absolutely, yes. But the real question is: At what terms and with what additional risks, risks not just to the success of underwriting the offering itself, but risk to the survivability of Conrail as a stand-alone company in the future. They are two distinctly different risks.

Another question. Could a public offering raise more than $1.2 billion for the Government? Maybe. But it could easily raise less if market conditions proved unfavorable or Conrail's earnings began to show signs of weakening, unless Morgan Stanley or a syndicate or some other party was willing to guarantee the price up front and take the risk that market conditions might prove unfavorable, or Conrail's earnings could plateau and in fact turn down.

But even putting aside the issue of what might happen to the market or to Conrail's earnings, Conrail is, I think by most railroad experts who have looked at, a low long-term growth—indeed, Mr. Crane said flat growth or flat unit volume—kind of company, with highly cyclical earnings and with the low PE's that are given to railroads generally, and in fact not just railroads, but other cyclical companies with low long-term growth potential like Ford, General Motors, some familiar names to you all, I think that would curb the company's value to investors.

As a stand-alone company, Conrail would not benefit from the strength that would be gotten by integration in another rail system, access to a parent company's capital, and that parent's access to additional capital, which is a very important point, or the ability to spread overhead costs over additional railroad.

So, as a stand-alone, Conrail will indeed—and I would advise my clients so—would present investors with greater risk; again, something that investors would probably use to restrain the amount of money that they would be willing to pay for Conrail stock.

As an independent publicly-owned company, Conrail would face a serious conflict, maybe irreconcilable, during periods of weak cyclical earnings and limited cash-flow, between the demands of stockholders for dependable and indeed growing dividends, and the capital spending requirements of the railroad.

If investors are not offered a reasonable dividend or think that it might be cut, putting aside the issue of whether any covenants might mandate such a cut, Conrail's value again to them would be reduced. The attachments of covenants, as I mentioned earlier, make this an even more important point.

Finally, whether we like it not, I think it's fair to say that a significant ownership interest by the labor unions would probably, at least in the minds of some investors, curb the value that they would be willing to pay for Conrail. That is a personal judgment on my part.

Would sale to Norfolk Southern create monopoly power? Well, I think the Justice Department and the other people that have done a market-by-market survey have far more detailed comments to make on that, but I will offer a few things from the point of view of somebody who deals with the industry and has to answer the question quite often.

There is precious little, precious little evidence of effective monopoly profits in the rail industry thus far. Indeed, if Conrail's scrap value, as Mr. Crane claims, is $3 billion or more, and no one has offered even $2 billion for Conrail's earnings, it is a sad comment on the profitability of railroads in the country, wouldn't you think?

The required divestiture of the east-west corridor in the heart of Conrail's operating territory is, I think, at least a partial answer to the anticompetitive issues that have been raised. The competitive restraints of both truck movements, which have plagued every railroad in the United States, and intermodal service from other railroads on truck into Conrail's territory are going to continue, whether it is owned by Conrail independently or as part of Norfolk Southern.

And, finally, keep in mind that only a subset of the shippers in the Northeast, those currently served by both Norfolk and Conrail, would be potentially adversely affected, even before the divestiture of the east-west corridor.

How about employment levels and job security? I think it is probably likely that a public offering and a stand-alone company or a purchase by a nonrail private buyer like Allegheny would probably mean modestly higher employment levels, but again, two things to keep in mind. In the long run, Conrail, no matter who owns it, can only support as many jobs as business levels, profitability, and the high price of rail labor will permit.

The real keys to employment prospects at Conrail or any other railroad are the wage demands of labor, labor's willingness to eliminate restrictive work rules to improve profitability, the state of manufacturing economy in the Northeast, and the degree to which shippers choose to utilize the rails, not who owns Conrail so much. And, in fact, as was brought out in the testimony of Mr. Crane, it is almost impossible for me to believe that Norfolk Southern would be physically able to eliminate half as many jobs as an independent Conrail management over the past 8 years.

And the second thing is a stand-alone Conrail entails greater risk and a good deal of risk devolves to the line's employees. If Conrail's profitability should lag in the future, the company would feel intense pressure from the capital markets and from stockholders for a smaller work force. I can testify to that. In fact, I am.

Even with rail profits up significantly from the lows reached during the last recession, rail managements invariably have to explain at each meeting with investors and security analysts why employment levels are where they are, and when they will decline further. If Conrail is a stand-alone company, I find it hard to believe that the stockholders won't make the same demands of an independent Conrail's management.

In some respects, this is a guess on what the future is going to look like for Conrail and for the stock market. What future scenario would make the choice of Norfolk Southern over a public offering look like a mistake? I think a very massive rally in the stock market could do that, or a very substantial increase in Conrail's earnings above their current levels.

What scenario would make the choice of a public offering over Norfolk look like a mistake? Well, obviously, a failure to successfully launch it would have that effect. But also, even if it's successful, this is the second risk that I am talking about—even if the initial offering is successful, a recession, a rapid growth in labor cost, heightened competition in the industry, further decline in the industrial base of the Northeast, could stress the fortunes of all the parties involved in the future and we might have to come back and deal with the issue again.

I am not predicting that or forecasting it, but it is an issue I think that has to be on the table.

Is no action a feasible option? Sure. Doing nothing is probably often an option, but let's remember that it costs money. At the very least, the cost in this case is the price of foregoing the $1.2 billion the Government could get for its share today. A delay might bring more favorable circumstances for a public offering, but it might not.

I have a couple of comments that I throw in on the proposal of Senator Heinz, and this is literally with 10 minutes' worth of thinking about it. If he really means to raise $1.2 billion in equity, the entire amount for the Government, and it would draw no cash from Conrail, that being one of the positives of it, I assume he means that that common stock would pay no dividends. That is going to be a harder stock to sell to investors.

If it can be done, though, it does ease, at least in some sense, the cash crunch that might occur in a severe recession. But it probably would not eliminate at least the possibility that Conrail could go cash-negative, at least for some point. It still leaves Conrail as a stand-alone company.

And the other issue is even if a public offering could raise exactly the same $1.2 billion that the Government could get, isn't it reasonable to think you might want something more to take on this second level of risk; that is, what happens in the future to an independent Conrail? The Government might demand more under those circumstances.

Thank you very much.

[The statement follows:]

STATEMENT OF JAMES M. VOYTKO, FIRST VICE PRESIDENT, PAINE WEBBER, INC.

Dear Mr. Chairman and members of the committee, my name is James Voytko. I am First Vice President and Transportation Analyst with PaineWebber Inc., a major brokerage and investment banking firm based in New York. Prior to joining PaineWebber, I served in a variety of posts here in Washington within the Interstate Commerce Commission, the Department of Energy and the Environmental Protection Agency.

I have been asked to comment on several of the key issues surrounding the transfer of Conrail to the private sector from the perspective of a securities analyst specializing in transportation. Before doing so, let me note that while neither I nor my firm have been actively advising any of the parties involved in the disposition of Conrail, I have been recommending Norfolk Southern's common stock to PaineWebber's clients for some time based on my belief that the stock price has not fully reflected the chance that Norfolk might receive approval to acquire Conrail.

Is $1.58 billion a fair price for Conrail?

Your decision on Conrail—if, when, how and for how much to transfer the company to private hands—is in part a financial decision. Putting aside for the moment the issue of the best means for disposing of Conrail, let me simply comment on whether $1.58 billion for 100% of Conrail (or $1.2 billion for the government's 85%), as has been offered by Norfolk Southern for instance (the $1.2 billion applies to Alleghany as well), is a reasonable price for a company with Conrail's current and prospective earnings, growth prospects, financial condition and past performance?

Briefly put, I believe the answer is yes. An offer of $1.58 billion for Conrail is reasonable because of the following:

The price/earnings ratio (P/E multiple) is reasonable in light of the P/E investors accord other railroads. First, keep in mind that no one familiar with Conrail's finances claims that as a private firm the company could have earned anything close to the $500 million reported for 1984. Assuming Conrail earns between $200 and $250 million in 1985 after the adjustments made once the company is private—e.g., wages rise to national standard, state and federal taxes are paid, and conservative labor protection costs are assumed—a total price of $1.58 billion reflects a P/E between 6.3 and 7.9. Table 1 shows the P/Es currently accorded the other major railroads based again on estimated 1985 earnings. Given Conrail's less than compelling earnings history, its downward trending traffic base in the Northeast, its highly cyclical traffic mix and the lack of significant, attractive non-railroad assets (such as large oil and gas reserves in the case of Burlington Northern and Union Pacific or extraordinary real estate holdings in the case of Sante Fe Southern Pacific) the multiple on Conrail's earnings reflected in a $1.58 billion price seems well in line with that accorded other major rail stocks.

TABLE 1

Company	Price February 26, 1985	Estimated 1985 EPS	Price/earnings ratio (P/E)
Burlington Northern	$54.13	$7.55	7.2
Norfolk Southern	66.25	7.95	8.3
Union Pacific	48.00	4.50	10.7
Sante Fe—Southern Pacific	28.38	2.90	9.8
CSX	25.75	3.20	8.0

	Price (billion)	Net income	Price/earnings ratio (P/E)
Conrail	$1.58	$200	7.9
		225	7.0
		250	6.4

The presence of covenants in the sale agreement acts to restrain Conrail's value. The Administration has sought to ensure that any buyer of Conrail maintain a strong financial structure and adequate service for an extended period of time through the use of covenants placing restrictions on the resale of assets, the extraction of cash and any reductions in capital spending. Depending on the performance of the economy, the industry and Conrail over the next five years, these covenants may or may not prove binding and therefore inflict additional costs on the buyer. However, since this is uncertain it is quite possible that the covenants also tend to depress the value of Conrail to any buyer who would have to conform to them.

Perhaps the most pointed response to the question of whether Conrail is worth more than $1.58 billion is simply this: Where is the party willing to put more hard cash on the table without burdening Conrail with additional debt and greater risk? The Administration held on a long and highly publicized search for bidders, the results of which are well known to you. Conrail may prove to be a bargain for Norfolk

Southern, Aleghany or any private buyer at the price negotiated by DOT, but if so it isn't obvious. If it were, I am confident we would have seen more than a few bids at levels higher than the current proposed price.

Is a public offering possible?

Yes. I believe a public offering of Conrail's stock is possible. However, the real question is not its feasibility but the price at which it is feasible, and the associated risks that inevitably must be borne by all the parties involved now and in the future under this option.

Could a public offering raise significantly more than $1.2 billion for the Government?

Maybe, but I suspect it is unlikely and could indeed net *less* if the offering were launched either during an unfavorable market, a weakening in Conrail's or the industry's performance or, worse yet, both. In truth, it is possible that market conditions might prove attractive and rail earnings along with Conrail's might be moving sharply upward again; but, unless this turns out to be a most unusual business cycle, such a scenario is not a good bet at present.

But even holding these factors neutral, a public offering still might fetch no more for the Government's interest in the company for the following reasons:

Conrail's multiple will be capped by the meager prospects for sustained improvement in rail traffic in the Northeast and its highly cyclical nature. It will be further restrained by the relatively low P/Es accorded other railroads with far better unit growth, finances and non-rail assets. (See Table 1)

As a stand-alone company, Conrail will not benefit from (1) integration into another rail system, (2) access to a parent company's capital and access to capital or (3) ability to spread overhead costs over additional revenue. Thus, as a stand-alone entity, Conrail will present investors with greater risk, a factor which will also act to restrain the company's value to investors.

As an independently publicly owned company, Conrail will face a conflict—an irreconcilable conflict during periods of weak cyclical earnings and limited cash flow—between the demands of stockholders for dependable and growing dividends and the capital spending requirements of the railroad. Of course, this competition is not novel; it is the normal state of affairs for most publicly traded companies. If investors are not offered a reasonable dividend or believe that the dividend possibly will be reduced if cash flow declines even modestly (ex any covenants mandating such a reduction), Conrail's value to them will be reduced. This will be true even if the company borrows to temporarily expand available cash to meet both demands.

The attachment of convenants in a public offering in combination with the greater risk to investors in a stand-alone company would lower Conrail's value to investors. Let us assume an investor is offered stock in a company that is restricted in its ability to maintain (needless to say raise) dividends to stockholders, sell assets to raise badly needed cash, reduce capital spending to conserve cash, substantially shrink the company's operations to preserve the concern or, in particular, sell the company at a premium. If that investor is rational, he is unlikely to pay as much as he might in the absence of these restrictions.

A significant ownership interest by the labor unions could curb the value placed on Conrail by investors concerned over the possibility that this would provide a point of leverage for higher wages and staffing levels at the company.

Would sale to Norfolk Southern create monopoly power?

Those who conducted the market-by-market study of the effects of the acquisition of Conrail by Norfolk Southern will have far more detailed and better supported views to offer on this issue. Nevertheless, in light of the recurring fear about rail monopolies I would offer a few observations from the point of view of an industry analyst which I believe are relevant to the proposed acquisition of Conrail by Norfolk Southern.

There is precious little evidence of effective monopoly in the rail industry thus far. Return on investment and return on equity within the industry ranges from poor to miserable when compared to corporate averages. If there are significant effective monopolies in the rail industry, where are the monopoly profits?

The required divestiture of an east-west corridor in the heart of Conrail's operating territory will enhance competition and mitigate any anti-competitive effects of a Conrail-Norfolk Southern combination.

The competitive restraints of both (1) truck movements and (2) intermodal service offered within portions of Conrail's territory by rails without directly competitive rail service will continue.

Finally keep in mind that only a subset of the shippers in the Northeast could be adversely affected even before divestiture of the east-west corridor (See Table 2).

TABLE 2

Shippers currently served by:	After Norfolk Southern-Conrail combination would be served by:[1]
Conrail	No change. Still served by only one railroad.
Conrail + CSX	No change. Still served by two railroads.
Norfolk + CSX	No change. Still served by two railroads.
Norfolk	No change. Still served by one railroad.
Norfolk & Conrail.	Reduction of service to one railroad. How many would gain access to new railroads introduced into east-west corridor?
CSX	No change. Still served by one railroad.

[1] This is, of course, a static view of a dynamic process. Opening or closing of gateways as well as future abandonments could make these outcomes more or less attractive from a competitive standpoint. Also, depending on the companies and routes selected, divestiture of the east-west corridor could serve to preserve and even enhance competition for some shippers.

How might rail service be affected by the choice between Norfolk Southern or a public offering?

In the near term, there are not likely to be major differences in the levels and certainty of service provided under either option. Moreover, in the long run it is quite likely that the shrinkage of the rail network in the U.S., as well as the Northeast, will leave Conrail's plant smaller than it is now under either option. The key difference is that as part of a larger rail system such as Norfolk Southern's Conrail (and Conrail's shippers) would benefit from greater operating economies, additional gateways and expanded use of faster run-through trains. Morever, during business downturns Conrail, as part of a larger rail network with a more diverse traffic base, might face less pressure for temporary reductions in service levels.

How are employment levels and job security affected by the choice between Norfolk Southern and a public offering?

It seems likely that, over the next several years, opting for a public offering—and thus a stand-alone Conrail—or purchase by a non-rail private buyer such as Alleghany means modestly higher employment levels. Nevertheless, three things should be kept in mind:

In the long run, Conrail—no matter who owns it—can only support as many jobs as business levels, profitability and the high price of rail labor will permit. The real keys to employment prospects at Conrail (or any other railroad) are the wage demands of rail labor, labor's willingness to eliminate restrictive work rules to improve profitability, the state of the manufacturing economy in the Northern U.S. and the degree to which shippers choose to utilize the rails. Moreover, it is virtually impossible to believe that even Norfolk Southern would be physically able to eliminate half as many jobs as an independent Conrail management has over the past eight years.

A stand-alone Conrail entails greater risk and a good deal of that risk devolves to the line's employees. How many people work for the Rock Island today? If Conrail's profitability should lag that of these companies, the company will feel intense pressure from the capital markets (in the form of higher interest rates or restricted access) to capital and from stockholders for a smaller workforce. Even with rail profits up significantly from the lows reached during the past recession, rail managements invariably have to explain at each meeting with investors and securities analysts why employment levels are what they are and when they will decline further.

What future scenario would make the choice of Norfolk Southern over a public offering look like a mistake?

Only two events would make a private sale of Conrail to Norfolk Southern (or any private bidder) look like a mistake several years hence. The first would be a significant rally in the stock market generally as investors raised substantially the price they were willing to pay for growing operating earnings (versus interest from bonds or cash investments). This could make Conrail and its associated operating earnings somewhat more valuable, though with the company's limited growth prospects how much more valuable is open to debate.

The second would be a significant and unexpected increase in Conrail's earnings so that, rather than declining as rate of growth in the economy slows or even turns negative, earnings would continue to march sharply upward. Both are possible I suppose (though the latter probably less so) but there is a distinct possibility neither may occur in this business cycle.

What scenario would make the choice of a public offering over Norfolk Southern look like a mistake?

First, if a public offering is launched into what turns out to be an unfavorable market or declining earnings at the company, it could yield no more or possibly less than a private sale with correspondingly greater risk. But a truly precipitous decline in Conrail's performance as a stand-alone company over the next five to ten years regardless of the cause—a recession, rapid growth in labor costs, heightened competition in the freight transportation industry, a further decline in the industrial base of the Northeast—could stress the fortunes of more than a few of the involved parties *even if* the initial offering is successful. Labor unions probably would be asked for wage and work rule concessions as well as additional job cuts. Shippers could face service reductions and stockholders could sustain dividend cuts and equity losses. I am not predicting such a catastrophe. However, the possibility must be considered, along with the possibility that, without "deep pockets" at Conrail and facing an impartial capital market which may or may not supply needed capital at affordable rates, afflicted constituencies might turn to the Government for assistance—again.

Is no action a feasible option?

Yes, doing nothing is often feasible but there is almost always a *cost* as well. At very least the cost in this case is the price of foregoing the $1.2 billion the government could get now with a private sale. The longer the delay, the greater the cost. Delay, of course, might bring more favorable circumstances for a public offering but the reverse could be true as well. Moreover, there is no guarantee that if all the private bidders—Norfolk, Southern, Alleghany, and the Marriott group are put on hold—they and their offers will still be around at a later date. Finally, even if the private sale option remains open indefinitely, the element of uncertainty and risk associated with the choice between a public offering and a private sale will not disappear.

This concludes my testimony. I want to thank you for the opportunity to appear before you today, and I would be happy to answer any questions you might have.

The CHAIRMAN. Thank you, sir.

Mr. Brody.

Mr. BRODY. Thank you, Mr. Chairman. I will try to be quite brief, as I spoke some yesterday, and a lot of the topic has been just covered very, very well by my predecessor speaker.

A few comments on public offering, and then, given the number of times that Senator Heinz referred to my lack of answering his proposal, a few comments on Senator Heinz' proposal.

First off, with respect to the public offering, let me underline what has already been drawn out. There is no firm commitment on the table. Let me also state that I have a somewhat different recollection of events than Mr. Saunders with respect to requests for seeing a firm commitment if such a firm commitment existed.

Following Secretary Dole's instructions to us, which followed a Conrail board meeting in December where Mr. Saunders brought up the possibility of the firm commitment, Goldman, Sachs had conversations with Morgan Stanley, indicating that the Secretary was interested in learning all that could be learned about the public offering proposal, and if there was a firm commitment to be put on the table, she would be interested in seeing it.

So we do have a different recollection of the facts there.

Second, I would comment that with respect to a public offering, markets change. And whatever can be done today will be different at some point in the future because the markets will be different.

On the question of value, without going into all of the sorts of subarguments, I would note that the management proposal which was placed on the table in January for a public offering gave a value of $1.4 billion, and it was not firm. It was not a firm commitment. And, furthermore, it did not comply with the covenants, particularly the key dividend covenant.

With covenants, it is our judgment that then in the marketplace and now in the marketplace, although it may be possible to achieve that $1.4 billion, it is highly unlikely in today's markets.

The next comment I would make on public offering is basically the ability to get it done. We have the belief that the ability to get it done depends on the market conditions at the time, it depends upon the price, it depends upon Conrail's performance at the time, and a number of other factors. With the covenants, we believe that there is a reasonable doubt as to the ability to accomplish the totality of the managements plan.

Going to Senator Heinz' notions of the alternative 1, alternative 2, give the public offering a try, there are a number of comments we would make.

One, Senator Heinz mentions that he doesn't like the management plan. He calls it a leveraged buyout, thereby implying, I guess, that it is not as financially strong as he would like to see it, and therefore going to a proposal to issue all common. It is our judgment, based on markets today, that it is highly unlikely with the covenants in the company, as Norfolk Southern has accepted, that a $1.2 billion common stock offering would be successful. I am not saying that it is impossible. I am just saying that it is highly unlikely.

And the final comment I would make on Senator Heinz' proposal is that I suspect that it misses the point of at least a number of people who have expressed it here today, a number of Senators who have ~~been on~~ this committee, and that is that just to get to the end point of having a public offering really doesn't address the long-term financial condition of Conrail. And the gentleman from Paine Webber, I think, covered that fully well.

The Chairman. Gentlemen, thank you very much.

Let me begin by asking a question which I am sure will betray my ignorance of your profession.

Senator Heinz distinguished between two ways of making a public offering. One was, as I understood it, just selling stock for whatever you can get for it. And the other was, getting an underwriter to guarantee, I suppose, a certain return for the sale of the stock.

Is that accurate? Mr. Saunders, could you answer that for the panel or give us a little explanation so that any fool could understand it?

Mr. Saunders. No. Well, let me try. I am not sure I understand, Mr. Chairman, Senator Heinz' proposal completely. I don't think you can break this business down into two simple underwriting schemes. Maybe the best way is to talk—what we normally do, and perhaps what this proposal suggests, and draw that distinction.

Normally, there is an underwriting commitment made in a regular public offering.

The Chairman. Normally there is?

Mr. Saunders. There is an underwriting commitment made that the underwriters act as principal. They buy the securities from the seller, whether it be a company or some other holder, and they can underwrite a commitment. They buy it for their own account. They then turn around and sell it to the public, be it individual or institutional investors. And that can take several different forms, and they are too complicated to go into.

The CHAIRMAN. In other words, the underwriter contracts with the seller of the stock to buy the stock from the seller, and then resells it?

Mr. SAUNDERS. That is correct.

The CHAIRMAN. That is a typical deal?

Mr. SAUNDERS. That is correct. One of the methods that may be creeping in here is a little of the so-called best efforts, which is an agency transaction; that is, not an underwriting commitment. One goes out and uses a firm and a group of firms, their best efforts to sell the securities at the highest price that they can get out of the marketplace. It does not have any underwriting commitment. There is no firm arrangement between the seller and the underwriters to take those securities at a price.

The CHAIRMAN. I don't want to interrupt you, except to just clarify my own understanding as you go along. Was that the first part of the Heinz proposal, the best efforts approach?

Mr. SAUNDERS. Well, I am not sure I understand completely his proposal, so I don't want to get into too much of that description. But it sounds like to me, when I heard just the end of it when I came in, that it sort of embodies a combination, if you will, of those two. And maybe, Ken, if you were here——

Mr. BRODY. Let me try a little bit, and I think we are going to change around a little bit what Senator Heinz was saying, but I think we are going to leave you with the result that he wanted to accomplish.

The normal type of underwriting, as Tom Saunders just went through it, involves an underwriting where the underwriters buy the securities from the seller and turn around and sell it to the public. But as a part of that mechanism, the underwriters, with the company, have gone around to as broad a market as they deem necessary in order to basically presell the shares. After the underwriters have a pretty good indication of where the market might really be for the effort, after this marketing effort of the shares, then the underwriters sit down with the seller and enter into the contract to purchase the stock.

So there is a good bit of knowledge that has been accumulated. And that is a normal underwriting, put in lay terms.

The CHAIRMAN. But at some point in time, the underwriter has made a commitment himself to purchase the stock, and if it turns out that some disaster has occurred and he can't in fact sell it to some third party, he has had it; is that right?

Mr. BRODY. That is fair. And sometimes underwriting is quite successful and sometimes the underwriters can lose money on underwriting. So it's not—underwriting is certainly not a lead pipe cinch.

The CHAIRMAN. And it is very typical that it operates that way?

Mr. BRODY. Yes, it is. What Senator Heinz, I think, was proposing—he wasn't saying it this way, but you can think of it in conceptual terms—is that all of that process could go on, but the Government would set an upset price, if you will. If the underwriters couldn't underwrite on that when they sat down to underwrite for

$1.2 billion of common stock, he would say well, then, it's off. I mean that would be a close approximation to it.

The other notion is best efforts, where you didn't have the underwriting, but it comes in layman's terms fairly close.

The CHAIRMAN. In other words, if you can't get $1.2, then he goes and tries to sell it to Norfolk Southern again.

Mr. BRODY. Right.

The CHAIRMAN. Whatever plan B was.

Mr. BRODY. And the only other comment I would make is you have to question whether Norfolk Southern would stand still while this was going on, and if it was unsuccessful, whether they wouldn't sort of take a little slice out of their price.

The CHAIRMAN. Let me ask you some questions, then. You are all underwriters, all of you are in this business. If Conrail were to come to you and say I want you to underwrite a stock offering for us, and I want you to give us a guarantee to buy the stock, would you be willing, assuming that it has the covenants that we would like in the deal, would you be willing to guarantee to the Government your own purchase of the stock, to turn over to the Government through your own purchase of the stock $1.2 billion?

Mr. SAUNDERS. Mr. Chairman, perhaps I should respond to that since we are the ones accused of raising that type of proposal. The short answer is yes, we would make a proposal with a group of investors and enter into a contract with the Government to buy its 85 percent interest and perhaps we would enter into that contract to buy it for $1.2 billion and find a way that, in the reoffering of that to the public, if we could generate more proceeds than that, to find a way to share the upside of those additional proceeds with the Government.

The CHAIRMAN. In other words, Morgan Stanley would, does now, undertake to buy the stock for $1.2 billion plus some sharing in any additional proceeds that could be realized in the resale of the stock?

Mr. SAUNDERS. Well, Morgan Stanley does not undertake at this table to do that, nor would a group of investors without hammering out a very explicit contractual arrangement with the Department of Transportation or whomever is the appropriate place.

I mean, recognize that the Norfolk Southern proposal and the others have been undergoing discussions and hammering out the details for the better part of a year, maybe longer. We have not entered into any discussions with anyone on those contractual matters, nor have we had an opportunity to do that. So that would require contractual arrangements in which we would then agree on that proposal and make a firm bid.

But in terms of would we do that, not only conceptually, but would we intend to do that, the answer is yes. But we could not do it today and we couldn't invite a group of people to join us and make a proposal on the basis of that sort of representation.

The CHAIRMAN. You would undertake to do it. You are not now entering into a contract with me. I don't have the authority to enter into one either. You are not entering into a contract, but you believe that you could put together a group under the leadership of Morgan Stanley which would produce $1.2 billion.

Mr. SAUNDERS. That is correct, Mr. Chairman.

The CHAIRMAN. Plus.

Mr. SAUNDERS. And we think possibly more. Yes; that's correct.

The CHAIRMAN. What would be the upside of what you think you could produce for the Government?

Mr. SAUNDERS. Well, I indicated in my testimony that I thought today that a public offering alternative could generate proceeds in the area of $1.5 billion for the Government, recognizing that once we made a proposal to buy, and if someone were to choose to enter into a contract with us to buy it for $1.2, we may in fact not decide to sell those securities immediately and try to do them all in 1 day.

There may be an optimal way to dispose of that 85 percent, such that we could maximize the proceeds over some period of time. That would be at the risk of that group of investors; that if the market went against them, they would suffer the consequences of that.

But there are any number of ways that we would approach the market in order to generate the highest proceeds that we could for those securities that we have purchased.

So I do not know that it is $1.5, $1.4, or $1.6. It would be driven by market conditions and the method of sale used.

The CHAIRMAN. Right.

Mr. Guest, how about Lehman Brothers? Would you undertake to commit your firm to $1.2 billion in an underwriting of this nature.

Mr. GUEST. My answer is I think that we should clarify what my colleagues here have said; that when the underwriting commitment is made, that is normally done the night before we can legally sell the securities. That is to say, we talk about price when we are dealing with a seller, a potential seller like the Government, we indicate what kind of price we think we could do it at.

On the basis of that, we get what is known as an exclusive, which means that other firms can't come and bid against us. On the basis of that exclusive, we then go around and sound out the market, just as was explained a minute ago by Mr. Brody.

Then finally, when we have got our feeling of what the market is—and perhaps I could develop a little further that sounding process, because I have been engaged in it in my time—and you talk to these potential investors, and you find that at so many dollars a share, somebody will be in. But if the offering price is $1 more, he says well, don't count on me for that unless the market has got to that point where he's still interested.

So right up to the last moment, we don't really know what the size of the demand is or at what price. And the last moment is really when we put our own cash on the line. These contracts—underwriting contracts—are standard forms. They have what is called a force majeure out. If there is a war or an earthquake, all bets are off, similar I believe to the Norfolk Southern contract with the Department.

But the one thing that is unusual—not unusual for us—but different—is the Norfolk Southern contract has a dollar figure written at the page where it says what the price is. In an underwriting contract, that figure is left blank until the very last day. It means, in layman's language, that the seller is taking the market risk. He doesn't know what the underwriter is going to say until the last day.

The **Chairman**. Well, we are the seller here. We are the client, and we have just gone to Morgan Stanley, and they tell us that they are very confident that they would be willing to pay us at least $1.2 and maybe $1.5, $1.6 billion, in that neighborhood.

Sounds like a pretty good deal to me.

Mr. **Guest**. If I understood Mr. Saunders correctly—and I read, of course—the letter that was written with regard to his proposal, it was contingent apparently on a great many further studies. It was contingent on the forming an underwriting syndicate, and it was contingent, very possibly, on the Department of Transportation waiving certain of these covenants that Norfolk Southern has accepted.

The **Chairman**. Well, let me rephrase the question. Would Lehman Brothers be willing to guarantee to the Government $1.2 billion?

Mr. **Guest**. As of this moment, Lehman Brothers would be prepared to consider a commitment, and we will tell you later what the price is.

The **Chairman**. How about Paine Webber, Mr Voytko?

Mr. **Voytko**. Well, based on my current knowledge and with the covenants attached to a public offering, I would be very reluctant to—in fact, I would not recommend to our underwriters that we risk our capital. And I would find it hard to go out to our clients and say risk your capital, based on what I know and the potential conflict in the covenants between capital spending needs of the railroad and dividend requirements.

That is just plain simple. There is a vulgar phrase: Put your money where your mouth is. And I would advise that we not put our money there.

The **Chairman**. Mr. Brody, how about Goldman, Sachs?

Mr. **Brody**. Let me clarify for myself what I think you're asking. I think you're asking the question: Would we today or in the very near future make a written commitment that we would live with the covenants and we would buy the railroad for $1.2 billion no matter how long Congress took to approve the process or no matter what happened to the market conditions? And the answer to that is a very simple and a very direct no.

Furthermore, we have heard similar statements from Morgan Stanley since December about the possibility of being able to put forth this group, and it has not yet appeared. And we are somewhat skeptical.

The **Chairman**. Is time of the essence here? Senator Specter indicated that one option would be to do nothing. That is, we in Congress could sit around or we could try our hand, as Senator Heinz proposed, at a public offering and if it didn't work out, then we could go right back to Norfolk Southern and say here we are; where is our $1.2 billion?

Is that feasible? Could we just delay the game? I would just like to go in the same rotation if I could. Mr. Saunders?

Mr. **Saunders**. Well, I think, Mr. Chairman, there may be substantial risk in going down that trail. One, we are obviously in no position to speak for Norfolk Southern as to whether they would continue to be there. But the method also suggests that in going out and trying to roundup orders and see if the public, institutional, individual, and so forth, would pay a higher price, that is not an easy task to do, particularly if the public views that it may be in that sort of contest.

I would envision that organizing and running that method would be somewhat difficult to do, and there is some risk that in fact you may not maximize the highest price on either proposal; that by putting them in competition and trying to effectively jack the price in that sense, may well send some investors away from participation in that process, just force them not to get into the flow. And I think that is a significant risk.

And so I would think that Senator Heinz' proposal would have to have more study and a lot more understanding before you could make the real judgments necessary to make those tradeoffs.

If I may, Mr. Chairman, I would like to make one comment. Two of my colleagues here have suggested the way that we do underwritings today, and they have been accurate in describing one way of doing financings. But to suggest that in today's investment banking business that no issues or firm commitments are made without talking to the marketplace is to not remember that, in fact, Goldman, Sachs and ourselves bought $300 million of Eastman Kodak 2 or 3 years ago without having a single conversation with any investor and without the market knowing that we intended to come. We made the bid, bought it for our own account, and then turned around and reoffered it to the public.

Goldman also joined us in buying $500 million of AT&T without any free marketing of an issue or any conversation. So there are any number of ways of making this firm type proposal. And I do not think it should be left on the record that there is only one way to approach this particular offering.

The **Chairman**. Mr. Saunders, you have responded to the Heinz question, but let me just ask you, just as your general advice to the Congress, whatever we do, whether it is a private sale, or a public sale, do you think we should just get on with it—make a decision? I don't mean the bum's rush approach, but I mean get on with a decision and do it one way or another. Or would it just be well to go back to the drawing board?

I would like your view, but it is at least my preliminary judgment that we really should get on with it. One, because from even Mr. Crane's testimony, rail transportation is probably not going to be booming in the future. We have had some good times and it would be a favorable time to sell Conrail for that reason.

Two, we have been at this now since 1981, and it seems to me that if we are at this for a period of 4 years and if the Department of Transportation goes through this really quite elaborate process over many, many months and they run up this mountain, and then we reach the top and we decide now we are going to come back down again, our credibility, not only as the seller of Conrail, but the Government's credibility, in general, is pretty well shot by the dry run approach.

Mr. **Saunders**. Mr. Chairman, I would agree with that. I think your assessment of the situation is correct. I think that the Secretary has conducted a very extensive elimination contest, if you will.

I will say that if I were one of those bidders, I would not have raised my bid, given the process that was going on.

There was no evidence that changing your proposal in the sense of the dollar amount would have possibly altered the outcome. So I don't think that was ever on the table. So if the bidding process was supposed to optimize proceeds, I am not certain it did that; although, on the other hand, given the other objectives that Congress was trying to meet, I am not sure that proceeds, to be quite frank, are the most compelling reason and way to sell this.

I do think you should get on with it, and I think you have also suggested the right characterization; it is a good market; it is a receptive market. Unless you want to continue to be a long-term investor in the railroad business, this is a good time.

I think one could raise a question about the wisdom of selling all of this road on one day and effectively being overly concerned about some market risk that the Government takes if it continued to hold a minority position or some position in Conrail. But that is another question that could be examined and examined, quite frankly, on the merits.

The CHAIRMAN. Mr. Guest.

Mr. GUEST. Which question am I responding to, Mr. Chairman?

The CHAIRMAN. There are really two parts to the question. The first part goes to the question of whether time is of the essence in your opinion; whether we should get on with this? The second part is the question of the Heinz approach of testing out a public offering, and if that doesn't work, then going through with the sale to Norfolk Southern.

Mr. GUEST. With regard to the timing, I believe that intentional delay beyond what the normal processes of the legislative procedure are would be a mistake for two reasons. One is that although the stock market has been acting well in the last few weeks and may very likely continue, the stock market has ups and downs, and to try on such an important issue as this to hit the market on the perfect date is taking a great gamble with the public's money.

The second reason why I believe that a delay would be undesirable is because the economic outlook, as Mr. Crane indicated, is a little uncertain for next year, whether there is going to be a recession, a mild one or a deep one. Who knows?

But things are good now, and the prospects are not for an increase, a substantial increase in the railroad business or earnings. So I don't believe that you can expect that this particular property will appreciate in value.

The third point from the Government's point of view as owner, I can speak perhaps from my personal experience. I have been in a firm, investment banking, all my life. In the last 10 years—the first firm I was with was sold to another firm, and then the combined firm was sold to a third firm.

The CHAIRMAN. I have been reading about you.

Mr. GUEST. Yes; I thought, sir, that you would have read about that in the papers.

This is a very poignant experience for people working in the firm, for yourselves, your colleagues, your employees, your families. And I can see—I think Mr. Claytor touched on this yesterday—that the Conrail organization, if there is a for sale sign up, and underneath—not yet—is going to be greatly demoralized, and so I don't think it is either businesslike or humane.

With regard to Senator Heinz' proposal, I believe in my initial oral testimony I did cover to some extent that point, or I did indicate that a best efforts offering without an underwriter puts a little bit of a tarnish on the merchandise that is being sold. The investor, probably rightly, gets the feeling that at the target price, the seller was unable to find an underwriter that would guarantee him that price, so he is therefore just going to try to see what he can do.

The last point I would make with regard to Norfolk Southern's posture, if that were to happen, I think Senator Heinz is assuming that he can always go back to Norfolk Southern at $1.2 billion.

Well, that is what we in Wall Street and, in fact, in the business world call a put option—if you have someone lined up, firm, that you can sell to within a certain period. Well, where I work, you don't get a put option for free.

The CHAIRMAN. Thank you.

Mr. VOYTKO. Well, as I mentioned in my testimony, delay costs money. At the very least, it will cost the Government the return that it could be getting from the $1.2 billion that is on the table.

The risk that you take is that on the upside, Conrail's earnings could explode and surprise everybody, although even Mr. Crane is not suggesting that. Or the market could rally significantly and bring more money in. On the other hand, just the opposite could happen.

As far as any significant delay, I would just like to mention a few things. We are pretty far along in the business cycle, and investors are not real interested in cyclical stocks as the cycle tends to age.

The second is, Conrail is heavily involved in the auto industry. There is some talk here in Washington about removing import restrictions which could affect Conrail in a very significant way.

The third thing is that there are some finite cash benefits that railroads in general received in 1981, Conrail as well, that are finite. And to the extent that investors get a sense that these things are, you know, that the horizon is seen, they become less interested.

At some point all railroads, including Conrail, are going to start paying cash taxes. The last thing, of course, is the tax reform proposal that was generated by the Treasury Department, which while it probably would not have any near-term effect on Conrail, eventually would make capital-intensive companies like Conrail larger payers of cash taxes. So all of these things would suggest that you might not want to delay forever.

The CHAIRMAN. Mr. Brody.

Mr. BRODY. Yes, Mr. Chairman. There is always the chance that by waiting, you can realize more money from the sale of Conrail. And that needs to be traded off against the risks. There is also always the chance that by waiting, you won't realize as much money, or you won't be able to sell Conrail.

It seems that if one were to drag out or cancel this round and start up a new one, it would be very difficult for the Government to have any credibility in presenting Conrail to private purchasers.

And, therefore, it is highly likely that it would be very difficult to get private purchasers in it again, because it takes an awful lot of work and a lot of time and a lot of money to go through this process.

The second point I would make is that markets are good now and we don't know what they will be like in the future. They could be better, they could be worse.

And third is at some point, the Government needs to end the uncertainty that the employees at all levels are facing in Conrail.

The CHAIRMAN. Now, the Department of Transportation has made it clear in setting out its own criteria for this sale that the price is one factor, but that it is not the dominant factor. Instead the principal concern is the ongoing health of rail transportation, the ongoing health of whatever entity operates rail transportation in the Northeast and Midwest.

I share that view personally. As I said earlier today, it would be wonderful if we could realize $200 or $300 million more money. Every bit helps when you have a deficit as large as the one we have. But the No. 1 concern is whether Conrail is going to continue in operation not just 2 or 3 or 4 or 5 years from now, but hopefully for quite some time, as long as it is needed.

You are investment bankers. I'm just a lawyer. My own estimate of the situation is as follows; that if you are looking at the long-term health of the entity, the problem with the management's proposal is that what you have after the sale is about $300 million less in cash, a commitment to pay dividends, a legal obligation as far as preferred stock dividends are concerned, and a commitment in the form of a clear intention with respect to common stock dividends payable to the public which is very much interested in receiving its dividends, and no deep pocket in case of trouble. On the other hand, with respect to a private sale to Norfolk Southern, you do not have the immediate payout in cash, you do not have the commitments to pay dividends, and you do have a very deep pocket.

So it would seem to me that as far as the health of the surviving entity that's operating Conrail is concerned, in this case, a private sale to Norfolk Southern is far better than would be a public offering under the terms as set forth by the Conrail management proposal.

Do you agree or disagree with that assessment? Mr. Saunders?

Mr. SAUNDERS. Mr. Chairman, I guess the only thing—you didn't say you were a country lawyer, so I feel a little safer. I think to take at this slice in time and look at Conrail and make the judgment that what you would turn into the private sector by way of a public offering, if someone were to choose to do that ultimately, and then to make the leap from there, that the business will be continued to appear exactly as it is today, that it will not change, that management will not have the flexibility or the foresight to continue to operate this business is a mistake.

I think the evidence suggests that companies that get themselves turned around can get on a roll, whether it's Lockheed or whether it's Chrysler, other companies that have been assisted through a bad time would suggest that if you get your act together, that you can turn those companies around and, in fact, make them into a very profitable enterprise.

I would suggest that this company, if it could get itself out from under perhaps the debate as to how it should be sold and could get on with pursuing as a free independent road, strategic objectives that could include changing its business and becoming a railroad that was in fact more like some of the other roads in this country, that it may in fact turn itself into a more interesting company than it is today, with even greater success opportunities.

I can't predict that, but I think for one to come to the judgment that you turn this out and it stops thinking and it stops producing and it stops taking advantage of its particular franchise is a mistake.

I think the question of deep pockets has been way overdone. All the analytical work that we have done, all the financial analysis, looking against projections over the next 4 or 5 years—and I might say that most roads don't put out any public projections in which anyone else is measuring them and their success opportunities, and whether or not what a downturn looks like against their efforts, all of those studies indicate to us that this company will have free and ready access to the capital markets in this country.

And I would say that the deepest pocket in this country are the capital markets, not the cash positions, or necessarily the financing flexibility afforded by Norfolk Southern.

If we are right, and you can come to the conclusion that this road has access to the capital markets in this country on a favorable basis compared to other roads, then the deep pocket argument is somewhat specious.

If you look at the financial ratios, we believe this company would be an AA company after the completion of a public offering. We don't see any evidence that it is constrained in terms of going into debt markets or the equity markets in the future to finance itself. So I am not onboard the deep pocket argument, and I don't think a true analysis would lead many people to draw the conclusion that's the only deep pocket.

And, finally, with respect to the proceeds question, I would agree with you completely that proceeds are not necessarily what should determine the right way to privatize Conrail if that's what Congress chooses to do at this time.

However, to sell this franchise for a net price which may be substantially below $1.2 billion is a serious question that someone should examine. Is that the right price to turn this franchise back over into the private sector? So proceeds are not the most important consideration when it relates to putting this in the market.

But there is a question, no matter how you do it, as to whether you do get the right proceeds and the highest proceeds for the taxpayer. And our analysis would suggest that we are not at that number yet.

And, finally, I don't think anyone has examined—we have seemed to have examined the implications for rail service in the Northeast, but it doesn't seem to me that there has been a fully—the possible domino effect on the whole rail system and transportation system in the country has been fully analyzed, if you make this combination, such that you create these two large roads in the East relative to the rest of the country, and what other people will do as they start to pursue their strategic alternatives in looking at this combination.

So it seems to me that I guess I am in some disagreement with your comments. I think fundamentally, your point on proceeds is absolutely correct, though.

The CHAIRMAN. Thank you, sir.

Mr. Guest.

Mr. GUEST. Well, Mr. Chairman, basically I concur with the remarks with which you led off this phase of the discussion; that my client, Norfolk Southern, is the best and the most appropriate purchaser for this property if it is decided it should be sold. And I have satisfied myself and the board of directors of the company that they are not jeopardizing their own financial future by buying the railroad at this price and on these terms.

And I might add that even though acquisitions sound easy, there are cases that we all know of where people have paid too much for a property that they thought was going to make them a lot of money and did not. And I am reminded a little bit of one railroad a few years ago that went into the oil business and with a group of partners, and drilled, I think, 12 dry holes in the Gulf of Mexico.

And therefore, I just feel that you want to make sure that the person you are selling to is somebody that is committed to the railroad business. And I don't like the idea of diversification unless you are so rich that you have goldplated the railroad and don't need any more.

So my answer is, I believe, that Norfolk Southern is qualified and that they can perform their commitments over a good long time.

The CHAIRMAN. Mr. Voytko.

Mr. VOYTKO. You characterized sort of Conrail after a public offering as being the same Conrail it was before, with the same fundamental opportunities and problems. And I would agree with that, except that, of course, you mentioned that they would have the additional burdens of dividends that only the future can tell whether they can meet or not.

You mentioned a number of folks that you were worried about. One of them was the stockholders. If Wall Street, and including myself and the gentlemen at this table, sell the stock and represent it fairly, you should not worry about the stockholders. They are big boys and girls. But I think you should worry about rail service and the disruption that might come if it didn't work.

The CHAIRMAN. I am not worried about stockholders at all. All I am saying is that in my own analysis of the situation, tentatively, that as far as the financial condition of Conrail is concerned, it is in much stronger financial condition if it does not begin by paying out Conrail cash for the purchase; committing itself to dividends, and having no deep pocket.

Mr. VOYTKO. I agree with that. I was just pointing out that there are certain folks that would get hurt in that, that probably should know what they are getting into at the very beginning.

The main point is that the rail industry is shrinking. It is shrinking very rapidly, and in all likelihood it will continue to shrink, and numerous examples from the last 4 years, even indeed from the last couple of months, witness the Chicago Milwaukee and the Soo Line. There are two ways to shrink to meet the market. One of them is through bankruptcies, which as we found out in Penn Central and Chicago Milwaukee and Rock Island, are very painful; and another way is through planned shrinkage within an individual company, which we found out is painful but it's doable. And it doesn't tend to involve the Government, at least in any significant way.

So if we are looking at the Northeast and potentially additional shrinkage in the area, it would be better for service and for all concerned if it happened at a planned pace rather than through a bankruptcy.

The **CHAIRMAN**. Mr. Brody.

Mr. **BRODY**. Hopefully, a simple and succinct answer to the question of financial strength. Norfolk Southern brings to Conrail a degree of financial strength and stability that Conrail does not achieve on its own.

The **CHAIRMAN**. Gentlemen, thank you very much. Very helpful testimony from each of you. I appreciate it.

The next witness is John Riley, Administrator of the Federal Railroad Administration.

Mr. Riley, thank you very much.

STATEMENT OF HON. JOHN RILEY, ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION

Mr. **RILEY**. Thank you, Mr. Chairman.

If the chairman will abide with me, I would like to, for my opening statement, put aside the prepared remarks and go directly to two or three of the points that the previous witnesses have raised, because I think they are important and I think I want to address them up front.

The **CHAIRMAN**. Your prepared remarks, as well as everybody else's, will be automatically included in the record.

Mr. **RILEY**. Thank you, Senator.

First, on delay. Mr. Chairman, while I believe that Congress should take the time it needs to analyze this to its own satisfaction, every single stakeholder in this transaction loses with delay.

Government loses because we continue to pay labor protection every year for Conrail, an indirect subsidy. The States lose, because Conrail does not pay State taxes while it is in Federal ownership. Employees lose because it delays the point at which they get the, roughly, $8,000 to $10,000 that every man would get under the Norfolk Southern offer, and they operate under a lower labor protection position than they will after the sale.

Small railroads lose because they continue to be faced with closed gateways. And, Mr. Chairman, I heard Conrail say there weren't any closed gateways, and I won't comment on that, but I suggest that the Chair ask Grand Trunk and P&LE when they testify if they have seen any closed gateways lately.

In addition, Government loses the time value of the $1.2 billion plus that we can get from the Norfolk Southern deal. Shippers have to continue to face uncertainty in their future planning. Mr. Chairman, I am not attempting to give a litany, but simply to point out that everyone who is a stakeholder in this transaction stands to lose by an unnecessary delay. And by unnecessary, I mean a decision to put off, rather than the time it takes Congress to make an intelligent decision.

The second point I want to address: Mr. Crane in his testimony made the point—and this leads to covenants—that covenants do not guarantee traffic and revenue levels. That is certainly true. But I want to make it very plain that I disagree strongly with the Conrail position on covenants. While covenants do not guarantee revenue and traffic levels, they do protect the cash position of the company and its capital investment, regardless of revenue levels and yields.

And, Mr. Chairman, it is simply true that an offer or a buyer who comes with those covenants better protects the company in the short run than one who comes without them. And the management offer is a good example. The management offer would have to commit twice as much in dividend payouts as the Norfolk Southern is allowed to pay, and that is just one small example of the impact the covenants have.

And, again, I hope this committee will raise to the shippers and to the communities and to the employees whether they feel safer with a company sold with covenants or without.

In addition, I want to respond to Mr. Crane's comment—and it was an interesting comment, I thought a revealing one because it highlights the problems of a stand-alone Conrail—that so long as management, working with its union employees, has the flexibility to meet the demands of the marketplace and can respond to economic cycles, there should be no concern for the future.

Mr. Chairman, Norfolk Southern has every bit as much flexibility to meet those demands, but many more resources to meet them with. Conrail has only two ways to go when it faces a downward business cycle. It can cut employees, as it has, to the tune of about 60,000; or it can cut off service. The Norfolk/Conrail has an upside resource. It has several hundred million dollars of additional traffic that come on to the system due to the merger. It has efficiencies that save Conrail money in operations. In addition, it has a broadened traffic base. Conrail has traditionally had a very narrow traffic base that has made it susceptible to swings in the economy.

The Norfolk Southern merger would broaden its base and make it less susceptible to swings of the economy. This is not to say that adaption to downward cycles is painless, but it is to say that a merged Norfolk/Conrail system is far better adapted to the risk of downward cycles than a stand-alone Conrail.

Mr. Chairman, let me wrap this up by giving, as I see it at this point, is the best underview comparison of what the Norfolk Southern has to offer and what a public offering has to offer by the criteria that we view as important.

First, on financial strength, there is nothing negative in the Norfolk Southern offer. It takes nothing away from Conrail. In contrast, the management public offer takes more cash, more preferred stock, and more dividends than any other option the Secretary had before her. And on the subject of capital markets, Mr. Chairman, you and I are the capital markets. We are the ones who go out and invest and buy stock. And I posit the question: Would you prefer to buy stock in a merged Norfolk/Conrail or in a stand-alone Conrail saddled with $600 million in preferred stock and $300 million less in cash?

Second, on financial strength, Norfolk Southern brings Conrail some pluses that no public offering, no matter how constructed, can ever bring. It brings the additional value of several hundred million dollars in traffic flows. It brings synergies. I will use one example. Norfolk Southern holding company borrows at the holding company level. They use the resources of all their holdings to borrow, so they can borrow more cheaply, less expensively than a stand-alone Conrail could. And if that saved them only 1 percentage point a year, that is tens of millions of dollars in extra buffer against recession that comes from that merger.

In addition, as I said a minute ago, Norfolk Southern brings Conrail a substantially stronger, broader, wider traffic base, and that has been a historic problem in northeastern railroads. No public offering, no matter how constructed, can bring that.

And my second criteria is service, and these are the same criteria we used 1 year ago when I came here for the first time. On service, the Norfolk Southern/Conrail merger in many areas means open gateways. It surely means stronger regional railroads with longer hauls. And it means cheaper north-south hauls for all shippers, because one can go north-south with single-line rates, and any commodity, particularly TOFC, that moves north-south, will move more cheaply.

Stand-alone Conrail does not give you that advantage, does not bring the lower rates, does not bring the stronger regionals; in fact, continues to leave regionals faced with closed gateways and short hauls all over the Northeast, and that is true no matter how you structure the public offering.

My third criterion, Mr. Chairman, is covenants. You know where we stand on covenants. I understand Mr. Crane's reticence to operate with the covenants, but I can only say that 15 other potential managers who came to the table with bids agreed to accept covenants and felt they could manage the company.

On the down side, I would rather have a company with covenants than without, and the public offering is not likely to have them, because I have not heard anyone commit to an underwriting if covenants of the type we have included are in that stock.

The price to Government under the Norfolk Southern proposal is a minimum of $1.2 billion. It is $1.1 billion under the management projection. And, again, Mr. Chairman, I could sit here and give you any conjecture I could think of on what the company could raise in a public offering, but when it came time to put the offering down on paper, the management proposal proposed to raise $1.1 billion. And the $300 million in cash is irrelevant to the cost comparison because either you don't accept it, in which case the numbers are $1.2 billion versus $1.1 billion, or you do accept it, in which case the numbers are $1.5 billion versus $1.4 billion.

In either case, the Norfolk Southern offer is higher. There is an absolute closing guarantee with the Norfolk Southern. They are good for it.

On the public offering we must conjecture, and even if it were the second most successful initial public offering in the history of the country, $300 to $400 million, it would still take 2 to 3 years to sell it.

Finally, there is clearly a knowledge factor. We know who the Norfolk Southern is. We know how they operate. We know who their managers are. That was very important to us, as the Secretary said yesterday, in eyeball-to-eyeball negotiations. With a public offering, you never know who the owner is going to be.

Even if one structures the public offering, as we have heard discussed here, with a group of industrial investors each buying a piece, you do not know who they will sell it to tomorrow. You do not know who they are or what interests, narrow or broad, have led them to make that initial investment.

Mr. Chairman, you do not know whether 10, 15, or 20 small investors have the same incentive to bring financial strength to the company as a single purchaser who has bet their existence on the future of Conrail.

Mr. Chairman, that is how I would compare the companies. The bottom line on all of it is that financial strength is a factor. If we have learned nothing else from the collapse of the Penn Central—and in my part of the country—I lived through this twice. I lived back here when the Penn Central went down; then I moved to Minnesota and I got to live through the Milwaukee and the Rock.

What we have learned is that financial strength is the best long-term guarantee of jobs and service and financial weakness is the best guarantee that jobs and service will decline.

Now, as we look out into the future—and this is perhaps the way I would like to leave this, Senator, and wrap it up before going to your questions—we know that Conrail this year, by their projections, by our projections, by NS's projections, by every projection I have seen, is having the best year they are going to have in 2 or 3 years. We know that their profits flattened in the fourth quarter. I cannot, obviously, conjecture on Conrail's profit picture for the first quarter of 1985, but let me say from what I have seen, it will not be an encouragement to public offering advocates.

Mr. Chairman, the point in all of that is not that Conrail is an imperiled company. It is not. If we thought Conrail could not stand alone, we would never have considered Alleghany or Marriott. But we do believe that the chance of it standing alone without demanding massive sacrifice from its communities and employees is far, far better in a merged combination with another carrier.

I have a chart. I think it has already been submitted. But over the last 20 years, Mr. Chairman, revenue ton-miles, traffic in the Northeast has fallen consistently and dramatically. There is no indication that that trend is going to change. And we have to prepare not just for the upside, but for the downside, to consider the worst case and build in protections for commumities.

I found a quote the other day that made this point in better language than I could possibly make it, and I would like to close with that comment. The quote goes as follows: "Notwithstanding recent gains in removing artificial constraints on its financial viability, Conrail nevertheless remains an inherently fragile entity. Neither law nor management can alter the dynamics of the Northeast economy or arrest the erosion of Conrail's market. The sale of Conrail to a nonrailroad entity fails to shore up Conrail's inherent vulnerability. A sale to Alleghany or Marriott interests represents, after all, a difference only of degree and not of kind from the public offering. Conrail would remain a regional carrier without committed reserves to abide the cyclical adversity which has beset every railroad that has ever operated in its territory. Such a transaction courts financial disaster for Conrail and practically guarantees its eventual return to Government ownership in the not-too-distant future."

Mr. Chairman, that is a quote from Hayes Watkins of CSX. And I believe that it accurately represents the down side. And we want this transaction to be different from the transactions that have been undertaken on this railroad for the last 20 years. We want to consider the down side. We want to plan for the worst case scenario. We want to make sure that once and for all, the people and the shippers of the Northeast region and their employees do not have to fear a reorganization every 10 years.

Thank you, Mr. Chairman.

The Chairman. Mr. Riley, this afternoon we are supposed to start at 2 o'clock. We have 4 panels, for a total of 15 witnesses, and our reporter is about ready to drop. My intention is to recess for about an hour, I hope, maybe 45 minutes at the end of your testimony, and then pick up with the afternoon hearing.

I do want to ask you a question, and if you could be as brief as possible. I want you to answer the question fully. But it really is one question with two parts to it. The question has to do with the effect on competition of the proposed sale.

We have had testimony from the Pennsylvania Senators indicating in their view that the result of the sale would be a significant reduction in competition; that there would be a number of communities where competition would be totally eliminated.

So there is the whole issue of captive shippers and competition that is eliminated by virtue of the sale.

There is a second related question, and that is the effect on CSX. The chairman of CSX, Mr. Watkins, is going to be testifying this afternoon, and I am sure he is going to express concerns on the part of his railroad as to what this does by way of hurting CSX.

So can you give us the benefit of your expertise on what the effect of this would be on rail competition and on the possibility of diversion from CSX?

Mr. Riley. Let me treat that as a two-part question, Senator, and I will call on the aid of my colleague, Mr. Rooney, in answering the first part.

Let me say in overview that the competitive issue is really a State-by-State, region-by-region issue. It is difficult to generalize.

The Chairman. Let's take Pennsylvania because we have two senators from Pennsylvania who are here today.

Mr. Riley. Mr. Chairman, there is no line overlap in the State of Pennsylvania east of Pittsburgh. When one gets to Pittsburgh, there is a competitive implication—Pittsburgh west. That was recognized by the Justice Department and it has been addressed by divestitures that will bring a new carrier into that region. That has two independent up sides.

The first, of course, is that it restores competition where competition would have been reduced by the shrinkage of one carrier. But the second is that the carrier being expanded outward, in this case the Pittsburgh & Lake Erie, is a carrier which employs about 1,000 people in the Pittsburgh market.

The problem the P&LE has had is isolation from prime traffic markets. It is brought outward to prime markets in Detroit, Toledo, Steubenville. That is a competitive plus.

Eastward of Pittsburgh, Mr. Chairman, and I say this with all respect to the concern that any community has when it faces change, it is difficult to see any down side for the State of Pennsylvania. It is, in fact, largely upside. Whether one wants to view it from the lack of concern over future cyclical changes that come from this merger, to the fact that so much of Pennsylvania's business is north-south business, to the extent it can be shipped more cheaply—and it will under this merger—they will open new markets to the South, and it will certainly benefit consumers in the North.

So that is a broad overview, but frankly, Mr. Chairman, Pennsylvania is not a State where there are many competitive issues. One cannot rationally suggest that a railroad of this size can be run across the Northern tier of the United States from a headquarters in Norfolk.

The **Chairman**. To the extent that it is possible to generalize with respect to the country as a whole, what would your comments be on the overall competition?

Mr. **Riley**. My comment would be that in an east-west sense, there would be imperceptible change, if any change, because of the very painful program of divestitures that has been negotiated. In a north-south sense, the new system will be a better and stronger competitor for CSX.

Mr. Chairman, I have never accepted the theory that one needs three Eastern railroads to match three western railroads. They do not directly compete with one another. There is no impact there.

Moreover, I have been deeply concerned that if there is a pairing up of eastern and western railroads into transcontinental railroads, the loser is Conrail because Conrail is the least attractive eastern market and it will be the one given the fewest choices.

So if, in fact, this merger means that we have five railroads rather than three transcontinental railroads, that may in fact be a very procompetitive impact.

The **Chairman**. Finally, with respect to CSX and the effect on CSX, would it be a disaster?

Mr. **Riley**. Mr. Chairman, we did not take the CSX issue lightly. We looked very hard at it. When we sent this to the Justice Department, we asked the Justice Department to look every bit as hard as we did.

Yesterday, Paul McGrath testified that in his view, the traffic diversions on a bar chart shown from CSX would have to be a very, very large bar chart. We agree with that.

On the B&O, you are dealing with a railroad system that in 1984 had a revenue ton-mile figure of 26.5 billion. Billion. There is no diversion number that we have seen indicating any significant threat to employment there.

But let me conclude with one comment on traffic diversions. Traffic diversions come about because the merged carrier offers the consumer a better deal. They offer the consumer lower prices, faster transit. That, in turn, puts pressure back on other carriers to offer the consumer better deals. And I don't believe we should stand in the way of that.

And as a piece of evidence on it, I went back to take a look at some old merger briefs, and I found a very interesting quote in the expert witness testimony filed by CSX Corp. in the CSX merger brief when they themselves were arguing to create single line service that at the time was, in the words of the ICC, longer than single line service available on any competitive railroad.

This was the CSX statement from Richard Barber: "Rail diversion alone provides no meaningful insight into the consolidation's prospective impact on competition. Of crucial importance is the reason why such diversions occur. Here, the key factor is the increased single line service that CSX will be able to offer to shippers. Despite the allegation that CSX will accomplish diversion by exercising routing power, by far the better explanation lies in the preference of shippers for better single line service. Since shippers prefer single line to interline service, and since it is shippers who route traffic, such diversion to CSX from other railroads is primarily the result of the expanded single line service.

"In this sense," and this is the sentence I want to emphasize, "the traffic and revenue which CSX will divert from other railroads and other modes is but a valid, quantitative measurement of the merger's pro-competitive public benefits."

Mr. Chairman, I suggest that how one views diversion depends on who has the single line service and whose ox is being gored. It is less an issue of policy than an issue of comparative advantage and the consumer is the winner.

The CHAIRMAN. I can see that since CSX is the ox that is about to be gored, we should know about it. Do you think that it will be?

Mr. RILEY. I agree with that, Mr. Chairman.

The CHAIRMAN. You agree that they will be gored, or that we should know about it?

Mr. RILEY. I believe that you should know about it. I share Paul McGrath's view that they are not to be gored because, Mr. Chairman, I am not in the business of putting railroads out of business. You should remember that after this merger is over, the comparative size and ratio between CSX and NS will be closer than it is today.

This is a Hertz-Avis issue. Right now CSX is Hertz; NS is Avis. I absolutely do not blame the officers of CSX for not wanting to be Avis. But you cannot escape the fact that right now, CSX is about 8,000 miles bigger than NS. After the merger, the merged NS/Conrail will be about 4,000 miles bigger than CSX.

My point, Mr. Chairman, is that this is not an issue of policy. It is indeed a Hertz-Avis issue. And where there is strong consumer advantage, we should not turn away from it simply to dictate who is Hertz and who is Avis.

The CHAIRMAN. Mr. Riley, thank you very much.

The committee will be in recess until 2:30.

[Whereupon, at 1:40 o'clock, p.m., the committee stood in recess, to reconvene at 2:30 o'clock p.m., this same day.]

SALE OF CONRAIL

THURSDAY, FEBRUARY 28, 1985

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The committee met, pursuant to recess, at 2:35 p.m., in room SR-253, Russell Senate Office Building, Hon. John C. Danforth (chairman of the committee) presiding.

The CHAIRMAN. First we have a labor panel this afternoon: Mr. William Mahoney, attorney for the Railway Labor Executives' Association; Mr. Richard Kilroy, president, Brotherhood of Railway & Airline Clerks; and Mr. Fred Hardin, president, United Transportation Union.

Mr. Mahoney, would you like to begin.

STATEMENTS OF WILLIAM MAHONEY, ATTORNEY, RAILWAY LABOR EXECUTIVES' ASSOCIATION, ACCOMPANIED BY BRIAN FREEMAN; RICHARD KILROY, PRESIDENT, BROTHERHOOD OF RAILWAY & AIRLINE CLERKS; AND FRED HARDIN, PRESIDENT, UNITED TRANSPORTATION UNION

Mr. MAHONEY. Thank you, Mr. Chairman.

As you know, the Railway Labor Executives' Association is an organization comprised of the chief executives of all of the standard railroad unions in the United States and representing all of the contract employees in the United States in the railroad industry, and therefore of course all of the employees on the Conrail system as well as the employees on those systems who are interested in Conrail.

First of all, I think I should say that the Railway Labor Executives Association at the outset has been interested in three basic objectives for Conrail: First of all, that it should be a viable independent railroad; and it should provide maximum service and maximum stability of employment for the employees; and should have a return to standard wages for all of the employees. That was their objective from the beginning.

In May 1981, they signed a 12-percent wage deferral agreement with Conrail, and that expired on July 1, 1984. This did two things. First of all, it saved Conrail, and no one I do not believe will dispute that; and second, it qualified the employees as purchasers of Conrail under section 1142 of the Northeast Rail Service Act.

Subsequent to that, the RLEA formed a task force committee in June 1982 looking toward the purchase of Conrail. This committee consisted of: Mr. Fred Hardin, president of the UTU and then chairman of the RLEA; Mr. Richard Kilroy, president of BRAC and executive secretary of the RLEA; Mr. O.M. Berge, president of the Brotherhood of Maintenance of Way Employees and now chairman of the RLEA; Mr. Andrew M. Ripp, international vice president of the International Brotherhood of Electrical Workers; and Mr. Albert H. Terriego, international vice president of the Transport Workers Union.

These gentlemen retained Mr. Brian Freeman as a financial consultant in September 1982. They prepared an offer, with Mr. Freeman's help, to purchase Conrail in April 1983 and submitted that to the Secretary of Transportation in June 1983. That offer laid on the desk of the Secretary for a year before any action was taken in any direction in this matter. RLEA received no encouragement from others at all during this time regarding this offer.

The Secretary invited, ultimately invited, bids to be submitted by June 18, 1984. The RLEA submitted a revised offer at that time, and the Department of Transportation apparently looked upon only three of those bids that were submitted as serious bids: the Marriott group, the Allegheny Corp., and the Norfolk Southern.

After that, months of intensive negotiations were conducted with the three bidders, particularly Allegheny and Marriott, because of RLEA's objective of maintaining Conrail as an independent railroad. We kept in very close, even daily, communication with DOT during this entire time.

Finally, on January 29, 1985, RLEA met and reviewed meticulously each of the four existing bids. After about 7 or 8 hours of intense discussion, during which time Secretary Dole visited us and spoke to us for about half an hour, discussing her concerns in this matter, there was a unanimous vote to endorse Allegheny.

A few days later Secretary Dole announced her recommendation of Norfolk Southern as the purchaser of Conrail. Earlier this month, agreements were signed by all but one RLEA member and Conrail to reinstate standard wages as of July 1, 1984. On February 21, a memorandum of understanding was signed by Allegheny and RLEA confirming the earlier unanimous vote by the RLEA. This was signed by the RLEA, with the exception of two of its members, by Chairman Berge.

We know that legislation must be enacted before any sale of Conrail can be consummated, and that that legislation may take any number of forms. Now, I cannot say that RLEA would accept any particular form. We certainly do not know what the ultimate form may be.

However, considering the enormous sacrifice made by the employees in foregoing and deferring their wages since the middle of 1981, and considering the fact that in 1981, April 1981, we had 81,000 jobs on that railroad and today there are something less than 40,000 jobs, I can say that the RLEA would unanimously oppose legislation which in its opinion did not create a viable railroad, did not ensure a company that had growth potential and that could ensure service and stability of employment and growth of employment, that could not provide standard wages, that did not provide the employees with the value of the wages which they have deferred, and which did not provide adequate protection for the remaining 40,000 employees of that railroad.

Thank you very much.

The **Chairman**. Thank you, sir.

Mr. Kilroy.

Mr. **Kilroy**. Thank you very much, Mr. Chairman. I appreciate the opportunity to appear before you today to express my views with respect to the privatization of Conrail.

First and foremost, I have a prepared statement which I trust will be placed in the record. I will not read that verbatim. I will only refer to it, and then after a few remarks I will be glad to answer any questions that the chairman or the committee members may have.

The primary thrust of my statement is that I am opposed in every kind of principle to the acquisition of Conrail by Norfolk Southern, which is in essence is in fact a merger. In every merger situation that we have ever been involved in, we lose employees.

The statement made in previous testimony that it may only be 1,200 and that by attrition, simply is not true. Our experience has shown that it is not true and it will not hold up. Even under ordinary business conditions, without a merger we would lose that many as a result of improved efficiencies and productivity.

But in any event, we oppose it because it is not in the best interest of the people we represent, not only on Conrail but on the Norfolk Southern, on CSX, on Grand Trunk Western, on other smaller railroads in the region. The concept that these railroads could be given some trackage rights as a result of forming this monopoly may look good on paper, but they could never compete with that giant Norfolk Southern-Conrail and they very soon would be squeezed out under a deregulated system, under the Staggers Act, where Norfolk Southern could set the rates so low that the smaller railroad could not compete and they would be run out of business.

The railroad industry has shrunk, as you know, in this country today for a number of reasons, but not the least of which has been mergers, and that has been the primary source of the reduction in trackage, facilities and service. We think enough is enough. We are down to six major railroads. There are some others out there still trying to get married, and perhaps they should.

But by the same token, in the Northeast here the Norfolk Southern is saying that they will provide competition to CSX. CSX has competition. It has competition from Norfolk Southern and it also has competition from Conrail. Is not three competitors better than two?

The shippers will lose, the communities will lose, the State of Pennsylvania will lose, no matter what the testimony was, the city of Philadelphia in particular, the headquarters office. We have been involved in mergers, Mr. Chairman, for the last 20 or 30 years, and wherever there is a merger ultimately there winds up only one real headquarters office. Take for example Penn Central and Conrail. Six railroads there involved all had headquarters offices located other than Philadelphia. Now everything is in Philadelphia.

The Norfolk Southern itself had a headquarters office at one time in Washington, DC. Now that corporate headquarters is in Norfolk and the railroad headquarters are at Roanoke and Atlanta, respectively.

So we know what happens to headquarters. They can have a covenant that says they will maintain a headquarters and they can have 15 people there and that will be a headquarters, whereas we have over some 2,000 today. So we know what the consequences of a merger are.

Now, the Conrail right now is an important part of the whole rail industry. Some 35 percent of all traffic originates or terminates on property of Conrail. You add Norfolk Southern into that and certainly it must run up to 50 or 60 percent.

So these Western roads who may feel like they are not involved in what happens in the Northeast and the Midwest will soon find out that the next step will be the transcontinental hookup with perhaps the UP, and then all the way across the country and then the monopoly will be complete.

Now, we have considered all of the proposals that have been made by the various buyers. The Department of Transportation has stated that they have worked with us, and it is true. But I want to emphasize to the committee that the Department of Transportation or the Federal Government owns 85 percent of that railroad. The employees own 15 percent.

So we know that we must be dealt with, the employees must be dealt with. They are part owners. Their stake in it is their lives, their futures, and what they have lost in jobs and wages for the past maybe 20 years, not the past 3 or 4.

Finally, after all of those sacrifices have been made, we together with management have come up with a railroad that is viable, profitable, and is in the railroad business, nothing else, that does nothing else but railroad business. And once we got it into shape, with the help of $7 billion of the taxpayers' money, now it seems to me that we are going to turn around and give it away.

And that is what it appears to every citizen that walks the street. When you take a corporation that is worth $3 to $4 billion in assets, has almost a $1 billion in cash, and you pay $1.2 billion for it, they will not understand, Mr. Chairman, that in the money market that is not the way it works.

And we do not believe it does, either. If you put it out for public sale, the public itself, all the taxpayers, can buy that stock. The employees as part owners have an incentive to see that the corporation succeeds in the future, as we did for the past 3½ years. We are the biggest guarantee. Management and labor would be the biggest guarantee that Conrail would stay viable. No deep pocket is any deeper than the employees and their wages and their benefits.

So we have—my particular point of view is that a public sale is good for everybody concerned: the Federal Government, the taxpayers, the shippers, and the employees. We have examined all of the proposals made by the various buyers.

I serve on a task force, as was stated by Mr. Mahoney, a five-man task force. And I can assure you, contrary to any testimony given here in the last 2 days, that there has been no negotiations with Norfolk Southern and that task force. None are scheduled. As far as I am concerned, none will be held with Norfolk Southern.

I am opposed to Norfolk Southern. I know of no labor union leader on the railroad that is in favor of Norfolk Southern. Norfolk

Southern was rejected by the RLEA as a buyer, and we are not holding any negotiations with them.

That is the extent of my testimony, Mr. Chairman. Thank you very much. I will be glad to answer any questions you may have.

[The statement follows:]

Statement of Richard I. Kilroy, President, Brotherhood of Railway, Airline and Steamship Clerks, Freight Handlers, Express and Station Employees

Mr. Chairman and Members of the Committee, the Department of Transportation's February 8 endorsement of Norfolk Southern is a step that would create havoc in the northeast and midwest United States, devastate the lives of thousands of rail employes, disrupt shippers and destroy competition. The Norfolk Southern is the one candidate overwhelmingly rejected by most of rail labor.

In 1976, Conrail was formed by the demise of six bankrupt railroads in the northest to assure continued freight movement vital to the entire country. Conrail's employes numbered 105,000 at that time and now the figure is below 38,000. Tens of thousands of employes have suffered through the bankruptcy of the Penn Central, endured previous other mergers, have had their lives disrupted due to the loss of jobs and headquarter transfers and now they are told that they won't suffer by the monopolistic takeover of the Norfolk Southern. The loss of jobs and the transfer of thousands of others will take place if the Norfolk Southern should gain control. That is what has happened in every railroad merger/acquisition ever consummated.

The CSX Corporation has sent a letter to all its employes expressing concern about a possible takeover of Conrail by the Norfolk Southern. The CSX has estimated GSX job losses between 4,000 and 6,000, resulting from the loss of railroad business due to the power monopoly of a Conrail takeover by the Norfolk Southern.

The Justice Department's Assistant Attorney General stated prior to the DOT's recommendation that Justice would oppose the Norfolk Southern takeover, without appropriate divestitures, since the proposed merger would violate both the Clayton Act and Interstate Commerce Act merger review standards. Now, we are led to believe that an entire reorganization of the northeast rail network involving four or five railroads will resolve the antitrust problems. Yet, the Grand Trunk Western, one of those roads involved in the divestiture, has claimed that some of the lines that Norfolk Southern plans to divest are undesirable and probably wouldn't offer shippers a real competitive alternative. The Norfolk Southern will be able to manipulate the entire market in the northeast and midwest. That Carrier will be able to put smaller railroads out of business and drastically reduce traffic to the CSX.

Of major concern to us is that a Norfolk Southern takeover of Conrail would decimate clerical forces on both roads, with a devastating impact on shippers, communities, and other affected railroads.

We, in BRAC, will vigorously oppose such a takeover. We call on Congress to consider a public sale approach as the most equitable way of preserving rail stability for employes, shippers, communities and the nation's taxpayers who have already invested $7 billion in a strong northeast rail network.

I support Senator Arlen Specter of Pennsylvania in his endorsement of the public sale concept. It is a workable transaction that is in the best interests of all parties. The public will be able to share in the upside of Conrail's future and the employes, shippers, and citizens of this nation will receive the best return for their tax dollars spent.

The Chairman. Thank you.

Mr. Hardin.

Mr. Hardin. Thank you, Mr. Chairman.

My name is Fred A. Hardin. I am international president of the United Transportation Union. This is a short statement, so I would like to read it.

UTU represents the great majority of operating employees employed by Conrail. We have approximately 9,000 employee members on Conrail and represent more employees of Conrail than any other union. Our members by a large majority voted in favor of the May 5, 1981, wage deferral of 12 percent, which has proven to be the salvation of Conrail.

In 1979 Conrail had over 85,000 employees and now that total has shrunk to approximately 36,000. According to the records of mid-month last month, when Mr. Crane became executive of Conrail there were 77,000 employees and as of last month there were 34,000. So those figures are a little different from some we have heard today.

It has been UTU's goal throughout the sale of Conrail by the Federal Government to protect and ensure four different and definite goals:

One, the absolute future of Conrail as a viable and financially secure railroad;

Two, return to standard national wages;

Three, recognition and payment of the deferred wages;

And four, adequate protection for its employees in the future.

In the complicated and difficult task of selling the railroad and returning it to other than Government ownership assigned to the DOT, we have been treated by the Secretary of Transportation in a very fair, equitable, and compassionate manner. Through the DOT insistence, we have had every opportunity to deal with each of the potential purchasers in order to protect our goals and our interests for the future of Conrail and its employees.

We realize that, although some of the rail labor groups have endorsed Allegheny as the successful purchaser and the DOT has recommended Norfolk Southern as its choice, that Congress will exercise its right and wisdom to review all offers and plans and then will either confirm or reject the recommendation by DOT.

UTU has not individually endorsed any potential purchaser, but does emphatically go on record as being opposed to the Conrail management proposal for a leveraged purchase that would surely cause Conrail to quickly return to its former position of bankruptcy, and another 4,000 employees being abandoned through termination of service to shippers, and abandonment of additional hundreds of miles of needed rail service to the shippers and to the public. The social costs of additional unemployment is tremendous, both to the Federal Government and to the affected States.

The DOT has suggested and in fact required certain guarantees and covenants that would ensure the future financial solvency of the railroad and its continued service and availability to the shippers and the general public. Those requirements cannot be satisfied by a public leveraged, debt-ridden plan that has been proposed by Mr. Crane and certain members of his board of directors.

Conrail is a very important segment of our national transportation system, our national economy, and our national defense system. Its future should be ensured by selling it to whomever can guarantee those necessary services. A deep pocket for possible recessions or other potential problems facing the transportation industry so far as security is concerned should be remembered.

We are all cognizant of the fact that this Government will never again bail out Conrail or ever again take over ownership to save it from bankruptcy. So let us make the correct decision now and ensure its existence and growth, rather than another crisis.

I have been involved in this as chairman for about 22 months and then as a member for the last couple of months, and it has been a very trying and difficult time. There were 15 potential purchasers, including us.

I would be glad to answer any questions. But there are two or three things said here this morning that really disturbed me, and that is, the emphasis has been placed today on the scrap value of Conrail. And then I heard the Morgan Stanley people say that oftentimes they went out and bought stock just the night before and then sold it.

And I am fearful that if this thing—I know if it would go under Mr. Crane's plan, Morgan Stanley or somebody would buy it and then scrap it, because it has been testified the scrap value. Well, we all know that the scrap value of Rock Island was 10 times the value of it as a railroad. But I think they are overlooking one thing. If it were to be scrapped, the social cost would be over a billion dollars a year in just cost of the people on unemployment.

There is another aspect I would like to mention. That is the fact that Mr. Crane has done an admirable job. He and I came off the same railroad and have been friends for years, and you all have bragged on him so much that he has gotten to believing in it.

But he has done an admirable job. But from 77,000 down to 34,000, and when you figure them at $40,000 each, fringe benefits, you know, you have got $160 million plus there.

But the employees—if you look at the figures, the employees' deferral is what saved Conrail. There have been thousands of miles abandoned. He projects many other hundreds of miles being abandoned and it has been stated here. I am sure that Norfolk Southern will exercise its right, or anybody will, under the Staggers Act to abandon track that does not make a profit.

But then we all ought to remember that when a plant closes in the Northeast it does not reopen in New York. They come to South Carolina or Georgia. So we have got to maintain service in the Northeast. Conrail is the most important railroad, probably, in the United States; 33 percent of all traffic originates or destinates on its lines. We need it. But I certainly hope that we exercise wisdom.

As I say, Mr. Crane is a friend of mine. But I cannot subscribe to a plan that will bankrupt the company. I have been over here for 7 years begging you all for money for Conrail, and I think the well has about run dry, and I want to make it safe this time forever.

And that is about all. Are there any questions?

The **CHAIRMAN**. Thank you very much.

Mr. Hardin, I understand your testimony to be that the United Transportation Union opposes the idea of a public sale and supports the idea of a private sale, but you have not taken a position as to whom the sale should be made to, is that right?

Mr. **HARDIN**. I am glad my Senator just came in. You know, he and I are South Carolinians.

Yes, I am violently opposed to Mr. Crane's plan.

The **CHAIRMAN**. I thought you were from Montana.

I could not believe South Carolina.

Mr. **HARDIN**. Well, most people think I am from New York, but I am really from South Carolina.

UTU is absolutely opposed to a leveraged buyout that will put the railroad back in bankruptcy. Now, we have not endorsed Norfolk Southern. They have not let the milk down yet.

But I think we made a terrible mistake in endorsing anybody. We could have kept on negotiating and twisting all of them some more.

The CHAIRMAN. But in any event, you are against the management——

Mr. HARDIN. Yes, absolutely.

The CHAIRMAN. And Mr. Kilroy, it is my understanding, I understand your testimony to be that you are against the Norfolk Southern sale and you are for the public offering, is that right?

Mr. KILROY. That is correct, Mr. Chairman. I do not characterize the public offering as my colleague does, either, as a debt-ridden type of situation. But I leave that argument to the investors.

The CHAIRMAN. In any event, your position is the reverse of Mr. Hardin's?

Mr. KILROY. On that particular issue, yes. I am very much opposed to the Norfolk Southern and am in favor of a public sale, much the way that Senator Specter is presenting.

The CHAIRMAN. Mr. Mahoney, you, speaking for the Railway Labor Executives Association, set out the criteria that were considered, but I did not hear you take a position one way or another.

Mr. MAHONEY. Well, the Railway Labor Executives Association, Mr. Chairman, as an association endorsed Allegheny; and second, with the absence of two of its members, signed an agreement with Allegheny, a memorandum of understanding which confirmed that endorsement.

The CHAIRMAN. Did you take a position on the Conrail management plan for a public offering?

Mr. MAHONEY. At that time a vote was taken, on January 29, rejecting that plan and rejecting the Norfolk Southern plan both.

The CHAIRMAN. Can you tell us what the vote was, or is that not appropriate?

Mr. MAHONEY. I do not know that that is appropriate. I will if you insist, but I would rather not.

Mr. HARDIN. Mr. Chairman, he works for us. I will tell you what the vote was.

Mr. MAHONEY. I do appreciate that, Mr. Hardin. You go right ahead.

Mr. HARDIN. I will get him off the hook.

First of all, the vote, the first vote—and, of course, you folks in the Senate know how many different ways things can be voted—but the first vote was that any vote that won by a majority would be declared unanimous.

Senator FORD. That sounds like us.

Mr. HARDIN. And then the second vote was that it would not be a weighted ballot, but each union would get one vote. Now when we voted for the wage deferral in 1981 I had 15,000 votes, but the other day I only had one. I lost a lot. And the assessments were voted on a weighted ballot. So I paid more money.

But, anyway, he told you exactly right, a majority. Mr. Kilroy had his position and I had mine, and the announcement was made that it was unanimous when it does not seem to be unanimous any more. But, however, I would like to make another point, Mr. Chairman, before we leave.

The May 1981 agreement which we mailed out to every individual employee on accepting a 12-percent wage deferral, three unions did not ratify it, would not sign it. All the rest of us did. Of course, I was the largest union. So we put the 12-percent wage deferral in effect and agreed. Mr. Crane put out instructions that the three unions should not sign it. It was applicable to them anyway; you know, just forget about them. So they never did get the 12-percent increase.

But in his statement this morning he says that Conrail's new labor agreements with 15 of its unions will return their members to industry wage levels. That announcement came out yesterday. He returned all of them to industry wage levels yesterday, except my 9,000. I would not sign an agreement to let him do what he should have done last July because it had a little clause in it that would take away all of my rights.

So I would not sign the agreement. So he has returned everybody to industry wages today except my 9,000 people. And just for information, if Mr. Watkins or any of you shippers have cars on Conrail I suggest you get them home quick.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Trible.

Senator TRIBLE. Mr. Chairman, I have no questions. I must say I benefitted from Mr. Hardin's testimony here today. You all are most welcome and we thank you for your contribution.

The CHAIRMAN. Senator Riegle.

Senator RIEGLE. Mr. Chairman, just for the record—and because I know the public following this is trying to make sense out of exactly what is involved here—I think it would be useful to have for the record the breakdown of the number of labor organizations that are involved here by name and by number of employees just so that we understand how many different labor organizations are involved. Can one of you just quickly give that summary for the record?

Mr. KILROY. I think Mr. Mahoney may have an actual count there that he can give to you. Let me say this, that I have another difference with my colleague on the size of our membership on Conrail. I believe I represent the largest number there and not the UTU. But we are very close.

UTU, myself, which is BRAC, and the maintenance of way represent the large numbers. On Conrail there are, if I recall, 16 unions all told having working members on Conrail. So I believe the three unions I just mentioned would have somewhere around 25,000 of the employees that are employed by Conrail, and that figure of how many employees are on Conrail seems to vary between 35,000, 36,000, up to 39,000, and I guess part of that problem is whether you are talking contract employees or nonagreement, management included.

So I think the figure might be probably somewhere around 39,000, if you included all of management.

Senator RIEGLE. Well, let us say there are then approximately 16 union organizations involved; is that the general agreement at the table?

Mr. KILROY. I think that is correct.

Mr. **Hardin**. It is either 16 or 17 and there are two others. They voted but they do not have any employees on Conrail, but there are two others. This announcement by Mr. Crane says 15, and I know that two of us have not signed it, so that would indicate that there are 17 with employee members.

Senator **Riegle**. Let me ask this question. Of the 16 or 17 unions involved here, how many of those are in active negotiations with Norfolk Southern now? Would any of you know?

Mr. **Kilroy**. Senator, I know of no union that is in any negotiations with the Norfolk Southern right now.

Mr. **Hardin**. I still am, and will negotiate with anybody that can buy Conrail.

Senator **Riegle**. Are you negotiating with Norfolk Southern now?

Mr. **Hardin**. I will tomorrow, if——

Senator **Riegle**. Tomorrow is different. I am asking whether you were yesterday or are today negotiating? Have you sat down with Norfolk Southern and started to begin what could be called a negotiation?

Mr. **Hardin**. Well, Senator, I am not debating the question. I met with them last week, yes, and a couple of other unions, and I understood that they wanted to meet tomorrow, but nothing definite. If they do, I will be there.

Senator **Riegle**. So you have had a negotiating session already with Norfolk Southern; is that correct?

Mr. **Hardin**. Yes.

Senator **Riegle**. How many of the other 17 unions have done so in addition to yourself?

Mr. **Hardin**. Bill was there. I will have to ask him.

Mr. **Mahoney**. Senator Riegle, what occurred was that the chairman of the RLEA who was a member of the task force, Mr. Ole Berge, was invited by the Secretary of Transportation to a meeting with her people, Mr. Birnley and Mr. Riley, Mr. Hardin and the Norfolk Southern representatives. And we met with them and went over some proposals they had, went over what we thought was wrong with their proposals, and we have done this, I think, probably on three different occasions.

The last one, I guess, was last week or so, a week or 10 days ago. It was understood at that meeting and as Mr. Berge made quite clear that he was not representing the RLEA as such there. He could not. He was a member of a task force that was required to do any negotiating that would be done, and he so informed them.

And the immediate DDT response to that was well, the task force is quite welcome to come in and negotiate at any time. That was when that meeting ended, at about that time, and no future date has been set for any other meetings, and Mr. Berge is unavailable this week. I do not know that he has spoken to Mr. Kilroy about it—apparently not—on any detail that has occurred.

Senator **Riegle**. So there has been one session, I take it, then.

Mr. **Mahoney**. No, there have been several.

Senator **Riegle**. There has been several sessions that you have taken part in with Norfolk Southern, presumably on possible labor arrangements?

Mr. MAHONEY. Oh, yes. How they would protect the employees, what the details of that would be. We have told them where that was insufficient and they have gone back and——

Senator RIEGLE. So you have been present. How many of the other 17 unions have been present in that set of discussions?

Mr. MAHONEY. Mr. Berge and Mr. Hardin. I think there were just two.

Senator RIEGLE. So that would be two out of the 17?

Mr. KILROY. Senator, I talked to Mr. Berge and Mr. Berge advised the DOT and Norfolk Southern at that meeting that he was not negotiating and would not, so I think the only union that was negotiating was UTU, Mr. Hardin, as he stated.

Senator RIEGLE. I do not want to get into the middle of the conflict, so do not misunderstand me. I just want to understand what is happening and what has happened, because yesterday when the Secretary was here I asked where rail labor was at this point and what had happened, and she was quite specific in responding to me, and I have yesterday's record in front of me.

She made it very clear in her comments that negotiations were taking place. The clear impression was given, I feel from rereading the testimony, that rail labor, broadly defined or together, was in the midst of these discussions and that they were going forward in quite a positive way. And she seemed to be quite optimistic that we were not that far from an understanding or an agreement.

Now I can read it all to you, but that was the thrust of the exchange—some of you might have been in the room yesterday. What I am trying to do is ascertain whether that would be the way the labor people themselves characterize it or if there is a difference of opinion here.

Mr. KILROY. Well, Senator, I find it hard to—I understood the testimony and I heard about the testimony yesterday, and read about it, and the Secretary, with all due respect to her and the Department, has a way of presenting situations that are somewhat different than they actually are. I hope I have said that as kindly as I can.

Senator RIEGLE. I am sure she will let you know if she thinks——

Mr. KILROY. We have had our differences of opinion over this. We have met personally over it and she knows my position. I certainly know hers. But I am stating that there has been several instances of this type of thing, where negotiations are not negotiations and then they become negotiations. And the task force is assigned by the RLEA, charged with that responsibility.

I serve on that task force. Now the RLEA in a session on January 29, after the votes that were talked about here, unanimously endorsed Alleghany. I put stipulations on that endorsement, that, without going into detail, they could not meet them and I backed off of that endorsement. The rest of rail labor, to my knowledge, still endorses Alleghany.

Their name is on the document that was signed by Mr. Berge. My name and the name of one of my divisions, the American Railway and Airline Supervisers, is not on there. So I cannot conceive that Ole Berge, who is chairman of that group, would do any negotiating when he himself has said he is in favor of Alleghany.

But the concept here, I believe, is that to bring in labor, if only one or two, and say now what do you want, you know, what can we give you, well, I do not think there is a price that I would accept to wipe out the number of jobs that I see are going to be wiped out.

Over the years we have had guarantees of lifetime jobs on Penn Central, guaranteed everybody. No matter what reason you were hurt, you were paid for life. It lasted 2 years. Under the 4R Act, we had another guarantee for life. That lasted almost 5 years.

So any type of protection agreement that is offered out and that says you cannot be hurt, I just do not believe it any more. You know, after a while you begin to get a little skeptical of those deals. So what I am saying is there is no negotiating.

Now Mr. Hardin, of course, is free—he is president of his own union—to negotiate with whoever he wants, but insofar as the task force is concerned no agent of the task force and no member of that task force is authorized or has any negotiations with Norfolk Southern.

Senator RIEGLE. I need to yield because the bell has rung on my time, but the sense I am left with here, unless it is further clarified along the way, is that of the 17 labor organizations apparently one for sure, and maybe two, could be characterized as being in a kind of negotiation posture, and that the other 15 or 16 would be characterized as not being in a negotiating posture.

Is that an accurate——

Mr. MAHONEY. Excuse me, Senator. I do not think you could characterize the Brotherhood of Maintenance of Way as in a negotiating posture. Mr. Berge came at the invitation of the Secretary. He discussed this with them, told them what he thought was wrong, and with Mr. Hardin, told them what they thought was wrong with the proposals that Norfolk Southern made, and also said that before—they could not take anything he, Mr. Berge, said as any kind of support or acknowledgement of anything, that he had to go back, he had to talk to the RLEA task force.

He was a representative of the RLEA and, therefore, they had to make that decision and they had to come to any future negotiating sessions that were going to be held.

Senator RIEGLE. Does that mean the numbers would be 16 and 1?

Mr. MAHONEY. Well, if you want to characterize it that way. I will let Mr. Hardin speak for himself.

Mr. HARDIN. I would appreciate if I could characterize my own definition of negotiations. This entire process—I have been in railroad negotiations for 30 years. This has been a negative type negotiation. Normally in a negotiation you tell a railroad if you will do so and so, I will do so and so. I have never told any of these potential purchasers what I would do. I have told them what I want you to do, and then they say well, if we do that, will you support us, and I said no, I will not veto you yet.

It has been a negative process. We never have negotiated as we negotiate with railroads or anything else, you know, on a positive basis. So yes, I have continued talking with Norfolk Southern.

Senator RIEGLE. You are in negotiations, what you would call negative negotiations?

Mr. HARDIN. I am in discussions with them that I hope will be favorable to me.

Senator **Riegle**. The point is that yesterday when I asked the Secretary, it was very clear from her testimony that she was advising me and the committee that there were negotiations, and the implication was that essentially rail labor, broadly defined, was involved. What I am hearing is of the 17 unions 16 are not, and you have to define yours with some care as being not actually in full negotiation as we would understand that word.

I just wanted to establish that, because this sets up a fairly sharp difference of opinion in terms of what we heard yesterday and what we are hearing today.

Mr. **Hardin**. Well, Norfolk Southern, since Norfolk Southern was recommended by the Secretary, I am sure Norfolk Southern made the statement many, many times that they would sit down with each and every or individually/collectively any way and try to work out anything that the employees wanted.

And apparently it may be that some of them, most of them, or all of them, have never done that. But I do not think that Mrs. Dole would deliberately mislead. I have dealt with seven Secretaries of Transportation and she has been the most reasonable, the most intelligent, and most compassionate woman I have ever dealt with. I think she has been overly fair, and I do not think she would mislead anyone. She might be in error about some small item.

Senator **Riegle**. I am sure you are right.

The **Chairman**. Senator Ford.

Senator **Ford**. Mr. Chairman, I think one of the main items of concern here is jobs, and that has been part of the interest of the committee. I become somewhat frustrated, as I think others do, with testimony. At one point we hear things are pretty good, and the next time they are not quite so good. I did not get all of your testimony, Mr. Kilroy, but I think you said that there was not any negotiating going on and there is not going to be any going on.

So that indicates that with regard to what happens, you are not going to be a part of it. Is that correct?

Mr. **Kilroy**. That is correct, Senator, unless, of course, as a union leader if I get to the point when this body, the Senate and Congress, tells me this is it, and you had better get in there and get what you can, maybe I have to do it then. I would go in there kicking and screaming.

But I was called upon by Congress and the Senate to take a look at all of the angles of this thing. I am no expert on stock markets and sales and those things, of how that works, but there are experts in the field and I just hope that the Senators would take a look at all of those.

The Department of Transportation is the same Department of Transportation that wanted to break up Conrail in the first place and sell it off in pieces. We opposed that and we were successful. I am not overly critical of the Secretary. She is also from the same State as my colleague, from South Carolina, and certainly they have a lot in common, and I am sure that they get along very well, and I do also.

I just have a sharp difference of opinion with her on this particular issue.

Senator **Ford**. Well, my dad always told me, if the price was right and one offered cash, and the other wanted credit, take the cash. It appears that one is offering cash and the other wants it on a long-term credit. I do not know how you operate personally or how your union operates, but if you were getting the money up front I think your union members would vote to take it.

That is what we need to look at as it relates to the sale. As I think the chairman said this morning, the price is one thing, but what the buyer can do for competition and the protection of employees is vitally important to us.

Now do you agree? What is your figure on the number of employees that would possibly lose their job if this sale is approved by Congress?

Mr. Kilroy. I think if the sale to Norfolk Southern was approved by Congress, counting in all the adverse effects of the acquisition, the coordination of facilities and the so-called efficiencies that they would put in, which they said they will, the effects on CSX and the other railroads involved in the offices, the general office in Philadelphia, there will be at least 10,000 less people on the merged carriers.

Senator Ford. Well, from those who oppose it, the figures are usually higher; from those in favor of it the figures are low. And we up here have to strike a balance, and so we put them together and divide by two and come out somewhere between 4,000 and 12,000 or 4,000 and 10,000. That would be about 7,000. And the testimony here this morning has been somewhere between 4,000 and 8,000 and yesterday somewhere between 4,000 and 8,000. You are opposed to it. You raised it another 2,000. I am going to consider that factor.

How much of a threat do you think those who oppose this sale are making, or how much speculation is being made as related to the loss of jobs and closing of shops and other facilities.

Mr. Kilroy. I do not understand the question.

Senator Ford. There is speculation as to what will be done if this sale goes through from those who oppose the decision that has been made by the Department of Transportation.

Mr. Kilroy. Of course, we are railroad people. We come out of the ranks, most of us, and I am from off the former Pennsylvania. I know about Altoona and I know about the Penn Central. I lived through it. So we have to go on our experiences of what happens in other situations when you have a merger.

The Norfolk Southern has a very up-to-date modern shop at Roanoke. Conrail has a likewise equally as good shop at Altoona. Now the obvious answer to that is if business declines, if there is a recession—and there is debates as to when it is going to come, how deep and all—but if and when it comes it is a cycle, as you know, and if it comes and there is less work both of those shops will not operate at full force.

That just stands to any good business man in his prudent judgment would have to lay people off.

Now there would be less effect, we believe, if Conrail had a separate shop, a separate railroad, had to maintain their own equipment, could not shift it over to another railroad, and vice versa. The services and the functions could not be combined because they are two separate railroads. One will not do the other's work as long as they are competitors.

So when we look at these things it is not merely speculation. It is historical fact of what happens and that weighs in heavily with our evaluation of why we oppose Norfolk Southern. Norfolk Southern is a good management, and we have as much trouble with management, whether it be Norfolk Southern or Conrail. They are all the same when it comes to labor relations.

We are trying to educate Mr. Crane a little better in that area now.

Senator **Ford**. It is almost too late, is it not?

Mr. **Kilroy**. No. I do not think it is too late. We are still working on that part of it. But, by the same token, they are both tough managements to deal with.

But when you put those railroads together we feel absolutely that historically you can look at any merger that has ever taken place in this country and look at what it has done to the numbers. Now that may not be true for the trainmen, for what we call the operating groups.

If there are trains to run, you have got to have a crew. But it is true for practically all of the other forces on the railroad.

Senator **Ford**. Well, if the price is right, you ship more coal. If there is more competition and the price declines, you will ship more coal. Then you will need more trains, and we will hire more miners and things will get somewhat better.

The Governor of Texas said the other day that 50 years ago they stopped Texans from robbing trains. Now they want, in this day and age, trains to stop robbing Texans. So the price is one thing.

One more question, Mr. Chairman, and then one for Mr. Hardin, and I will stop. You said something in your statement, Mr. Kilroy, about a transcontinental hookup. Is that a possibility? Are you looking forward to that? Would a transcontinental really reduce employees? Are you proposing that?

Mr. **Kilroy**. I am suggesting that has been in the minds of people in the railroad industry for a number of years that the mergers could ultimately wind up in a transcontinental hookup coast to coast. So far that has not happened.

But as you shrink the number of railroads from three in the West and three in the East, you shrink that down to two, it seems to me that the logical step, and Marriott, Bill Marriott, who had made a proposal to buy Conrail, had stated in one of our meetings that that was an interesting proposition, to look down the road and see the possibility of a transcontinental railroad.

So, I think that possibility is there. I think investors and entrepreneurs look at that, and I think that is something that has to be considered. I cannot say that it will or will not happen, but I think it is a logical step once you get these railroads in the Eastern part of the country shrunk down to where there would be only two major railroads. Pretty soon there would maybe only be one.

Senator **Ford**. Mr. Hardin, if this recommendation of the Department of Transportation is approved, how many employees over a period of time do you think will be lost?

Mr. **Hardin**. Well, Senator Ford, I agree with my associate. He and I are good friends. We just differ on this. Mr. Crane's 5-year plan proposed a possible loss of 4,520 more jobs. That is his 5-year projection, which is a matter of record.

Now, as I said, and I say it once again, I have not endorsed Norfolk Southern. They have got to come a long way further. But their plan, they will tell you, in each craft and class how many people will be affected, and their affected people will be less if the Justice Department mandates are carried out because they will transfer about 1,200 employees over to the new competitive lines that will be established through a mandate of the Justice Department.

They have given us a list of the number of employees in each craft, and they project a maximum of about 2,500 in 4 years less attrition.

At the same time, Norfolk Southern indicates that they will need 700 new Conrail employees for the new traffic that now does not come to the northeast because of the Conrail surcharge. So, I am like Dick Kilroy. Everyone knows any company is going to eliminate employees if they can, but I cannot say Norfolk Southern has not been forthright. They have given me the number of people that would be affected in my craft out of the thousands that I have, and it would probably be about 400 in 4 years.

Senator FORD. Less attrition?

Mr. HARDIN. No, with attrition. Attrition runs at 8 percent, so it would probably erode that. I know that they are going to in the future, through Staggers, they may abandon some more track, but any other railroad will. Anybody is going to exercise their right.

But their figures have been very candid, and I think they are honest, and they are far, far less than Mr. Crane's potential in his 5-year plan, and there is no doubt about it that right now there is a lot of traffic traveling on the highways, up the Atlantic coast, piggyback, that is being trucked because of the surcharge, $100 a car on Conrail.

I do not think anybody knows, but I do not think that Norfolk Southern or Allegheny or anybody else has been reluctant to give us their actual figures, and all we can ask for is—and I want to correct my colleague on one thing, Senator Ford. Mrs. Dole is not from South Carolina. Not originally. With due respect to Senator Helms, she is from upper South Carolina.

Which is sometimes referred to as North Carolina.

Senator FORD. Mr. Chairman, I think that it is a ray of sunshine to have a man like Mr. Hardin here who can negotiate with humor.

The CHAIRMAN. Senator Hollings?

Senator HOLLINGS. Well, I agree, Senator Ford. I appreciate, Mr. Hardin, your appearance, and Mr. Kilroy. Now; explain that surcharge that you were talking about. I am just learning about that, and Mr. Crane's 5-year plan. In other words, he, by attrition or otherwise, is going to lose some employees himself under the continued Conrail operation if nothing happens during the 5 years?

Mr. HARDIN. Well, I have two attorneys here. I could let them explain it. But I will just explain it honestly.

Under the Railway Organization Act, the railroad could put on a surcharge to break even, and it is my understanding that Conrail has had a surcharge on cars that normally would come up through the Carolinas, Virginia, into Potomac yard, and then on up the corridor to Baltimore, Philadelphia, Washington, New York, and much of that traffic now is being transported by truck over the highway rather than piggyback because of a surcharge that was legal for Conrail to put on.

And it is my understanding that, of course, if Norfolk Southern or I am sure if Alleghany purchases Conrail, they wipe out that surcharge, would lessen the freight rate and get many hundred cars back on the rail.

Now, the 5-year plan, Mr. Crane's 5-year plan was made a matter of record a couple of years ago. How many possible—how many more miles he could abandon, how many more miles were in the project to be abandoned in the next 5 years, and a loss of up to 4,500 more employees, and I think that is all in the record, and we can certainly furnish it.

Senator HOLLINGS. So 4,500 employees—whether Congress acts or does not act, we have impending a loss of some 4,500 jobs one way or the other. Is that right?

Mr. KILROY. That would happen regardless of whether it goes into Norfolk Southern or stays under Conrail.

Senator HOLLINGS. That is what I am saying.

Mr. KILROY. Under the business plan, projecting the revenue and the carloads, what they did as required by USRA, they have to project what their business needs are going to be. When business goes down, the number of employees goes down. They projected the economy over the 5-year period and said, this is what would happen in the 5-year period. The traffic level would be so and so. The number of employees would be reduced. That would have to happen the same if Norfolk Southern took over, assuming the same figures, the same revenue, same figures. Those numbers would have to come down anyway, so that is why I say that the numbers of job losses are a little hard to nail down because if we do nothing we are going to lose jobs in the next 5-year period.

Senator HOLLINGS. Let me ask, what do you favor? Is it the Allegheny proposal?

Mr. KILROY. No, sir, I do not, Senator, favor the Alleghany proposal.

Senator HOLLINGS. I thought someone did, employees or——

Mr. KILROY. Everybody but me and another union that is a division of mine signed an agreement supporting Alleghany.

Senator HOLLINGS. Who is that? No one here right now favors Alleghany?

Mr. KILROY. Mr. Hardin is part of that.

Senator HOLLINGS. Mahoney does?

Mr. MAHONEY. The unions I represent, other than Mr. Kilroy's union, and as he said, which constitutes two members of the RLEA, himself and the president of the American Air & Rail Supervisors Association, all of the others signed the agreement confirming the endorsement of Allegheny.

Senator HOLLINGS. Tell us about Alleghany, Mr. Mahoney. What group is that? That is not the airline. What do they run?

Mr. MAHONEY. That is the Alleghany Corp.

Senator HOLLINGS. Who are they?

Mr. MAHONEY. Some years back, or recently, sold the IDS, Investors' Diversified Services to American Express, and if you want to get a better rundown on it, you could ask Mr. Freeman, who has been dealing with them, who is sitting on my right, who is a financial consultant to the RLEA.

Senator **Hollings**. Mr. Freeman, I am just trying to find out, what about Alleghany?

Mr. **Freeman**. Alleghany Corp. is basically a private investment company.

Senator **Hollings**. What do they run right now?

Mr. **Freeman**. At this point in time they are sitting on a lot of cash. They have a small insurance company, as I recall, or a small operating company. They have sold the bulk of their holdings, as Mr. Mahoney indicated, IDS, to American Express, and have cash and American Express stock, current value about——

Senator **Hollings**. You say they are sitting on a lot of cash and looking for an investment. In terms of a billion or so, they have the money to put up?

Mr. **Freeman**. Yes.

Senator **Hollings**. We heard Mr. Crane testify earlier that Conrail was a very valuable operation, with at least a junk value of $3 billion, and that Norfolk Southern was only offering $1.2 billion. Why, sitting on a lot of cash, did they not offer more than $1.2 billion?

Mr. **Freeman**. Why did not the RLEA offer more than $1.2 billion?

Senator **Hollings**. No, why did Alleghany not offer more?

Mr. **Freeman**. Because as a going concern, Conrail's value is not substantially more than $1.2 billion, if it is $1.2 billion.

Senator **Hollings**. If it is $1.2 billion. You think $1.2 billion is a pretty good offer?

Mr. **Freeman**. My personal view? Yes. I think it is probably for this railroad the high end of the range of reason.

Senator **Hollings**. Mr. Hardin, you wanted to say something?

Mr. **Hardin**. I wanted to say before you came in the room, Senator, the thing that disturbed me the most this morning was so much conversation about the scrap value.

Senator **Hollings**. That was out of context to me. No one is going to scrap it.

Mr. **Hardin**. Some of us should get together quick and buy it for $1.2 billion, if it is worth $3.2 billion in scrap. That is what Rock Island did, and that is the reason I am opposed to the public sale.

Senator **Hollings**. We do not want to scrap it. You think that is what will occur if we go down that public sale road?

Mr. **Hardin**. It could. There would not be any covenants or guarantees.

Mr. **Kilroy**. Senator, that is what the DOT wanted to do in 1981, was not scrap it, but scrap a lot of it and get rid of the rest of it to whichever railroad would pick up a portion of it. The public sale does not propose selling off Conrail for scrap. That was only an equation used this morning in the testimony that I heard as to, in answer to questions, what is the value of this railroad.

So, you add in such items as scrap value, which anybody does. What does it bring you if you just closed down and sold everything you had? But everybody knows that that is not the true price of a company, scrap value, especially a railroad.

No one is going to let this railroad go for scrap. It will never go for scrap. It is too valuable. When labor made its offer to buy Conrail, you could not sell it to anybody. When it started making money, they came up out of the woodwork.

So, I am inclined to believe that Conrail is a very valuable piece of property or there would not have been so many people bidding so much money for it.

Senator HOLLINGS. But none of them made the bid that Norfolk Southern made.

Mr. KILROY. I think the public offering can bring more money than Norfolk Southern.

Senator HOLLINGS. Why not get a public offering together. The only ones talking are we politicians running around about public offering, public offering. The market is there, and no one has prevented it, but under Mr. Crane and others who have been suggesting it now for quite some time, I have not seen it come forth. I think it ought to be understood that we are not denying it. It is just that the market is denying the public offering.

You get a group together—I have challenged Mr. Crane, and I challenge my friend, Senator Lautenberg, and others who have come up here.

Mr. KILROY. We would love to have the opportunity. The employees made a proposal to the DOT for a public offering, and we would get a group together to underwrite it, and she rejected that.

Senator HOLLINGS. Well, if you have anything like that, please submit it to the committee. I would be interested in seeing it.

Mr. KILROY. All right. Thank you, Senator.

The CHAIRMAN. Senator Trible?

Senator TRIBLE. Thank you, Mr. Chairman. Just a couple of quick questions, gentlemen. What is the current count of Conrail employees, and how many employees do each of you represent?

Mr. HARDIN. That is almost impossible. We had a count last month. It looks like right now there are 34,000 to 35,000 employees. About 5,000 of them are nonunion. Of course, the rest are executive. About 29,000 union employees.

I think the last count we had a couple of weeks ago, I had about 8,895, and in the engineers had about 2,400, and Mr. Kilroy somewhere around 8,000, but a total of—and Mr. Berg, the maintenance of way is the next largest, and then 100, 800, and on down to just a few.

Mr. KILROY. Senator, what they base most of their figures, the figure that you will get will be so-called midmonth count that they give to the ICC, so on a certain day in the middle of the month, they look at the payroll and see how many people are working that day, and that is the so-called count.

It is not really a totally accurate count. But it is that day, how many people are working. But the management, I am sure, could furnish the committee with an accurate figure of at least at the end of December 1984 how many employees they had on the payroll.

Senator TRIBLE. It is probably close enough for Government action.

Mr. KILROY. I think the figure—I agree with Mr. Hardin—is somewhere around 35,000 or 36,000.

Senator **Trible**. You indicated that there was a meeting of the labor community, and that you voted on the various alternatives, that it was a split decision, but by the rules adopted by the meeting it was a unanimous result.

Mr. **Kilroy**. No, that is not correct, Senator.

Senator **Trible**. Correct the record, then.

Mr. **Kilroy**. The votes that were taken on the various options before us, at that time we had before us the public sale, the J.W. Marriott proposal, the Alleghany proposal, the Norfolk Southern. Now, there was a difference of opinion. We are a diverse group in the RLEA.

Much like this august body, we just do not always see eye to eye. But in any event, we discussed these things for 7 hours, and then we proceeded to vote, and we proceeded to vote one by one as to whether we would support this one, this one, or this one.

The public sale idea, management's proposed public sale, was defeated. In other words, the majority did not vote for it.

Senator **Trible**. What was the outcome of those votes?

Mr. **Kilroy**. The numbers, I do not recall. It is by more than one or two votes, anyway. You know, it was not real close. Mr. Hardin, he said something this morning that he might have gotten railroaded in that vote because we did not have a weighted vote, but you know how that works, Senator. It all depends on whose ox is being gored as to how you want to count votes. It all depends on what day it is. In other types of votes Mr. Hardin goes the other way, and I do not blame him. That is the way the game is played.

Senator **Trible**. Mr. Hardin, we will give you a chance in just a minute.

Mr. **Kilroy**. You see, I represented even more people than he did, and I only got one vote, so no big problem, but in any event the ultimate result was that the only viable alternative left was the Alleghany Corp., and their proposal on its surface was pretty damned good, because it included more stock for the employees in the company than any of the offers laid on the table.

Now, the value of stock to us has twofold value. We think it will be worth more in the future. It has in many other types of operations like the Chicago and North Western Railroad, for example, and it is worth more than the dollars and cents that somebody might want to buy you out today and say here is $10,000.

You give up your 15 percent ESOP and you wipe out the debt for the $360 million you put in. That is very tempting to an individual, especially a poor railroad man who never gets that much money together at one time in his life. But as a union leader I would have to say, look, that stock in 2, 3, or 4 years, assuming a good business climate, may be worth double that, and you can become a beneficiary on the up side.

You will be part owner of that company, have two members or so on the board of directors. The Alleghany said three. So we unanimously, every labor union there voted for Alleghany. It was not a question of just a majority and then making it unanimous. Everybody voted.

We endorsed Alleghany, held a press conference, announced it to the press. There were conditions placed upon accepting Alleghany. I put one specific one on myself, that they immediately restore wages to the industry level on the basis of the Department of Transportation. The Secretary said that if we endorsed one of the buyers, she would herself go to the board of directors, and instruct Mr. Crane to put the wages back.

We selected Allegheny. Two days later she selected Norfolk Southern, and there went our wages. In the meantime, of course, we made a deal with Mr. Crane and got our wages anyway.

Senator TRIBLE. Mr. Kilroy, let me reclaim my time and ask you this. Assuming you had a weighted ballot, would it have been the same result on the Norfolk Southern proposal?

Mr. KILROY. I would think it would—Norfolk Southern would have still lost. It could have been closer.

Senator TRIBLE. Mr. Hardin, what is your view on that?

Mr. HARDIN. My memory is rather clear on the voting. The first thing, and bear in mind I am considering you are asking me questions. You are entitled to answers. And I am not debating it, but I remember it because I got beat so much. The first thing was Mr. Crane's proposal. It went down 14 to 5.

Then I lost on all the rest of the votes 12 to 7, and of course they were declared unanimous, and it was through an elimination process. I think the next ballot was, do we consider Marriott? No, 12 to 7. Do we consider continuing to consider Norfolk Southern? And of course I wanted to leave at least two of them in there for negotiating purposes. But no, I went down on that 12 to 7.

So then it was declared Alleghany was the one that was left, and there was not a vote to reject Alleghany, so Alleghany was declared unanimous, and had it been a weighted ballot, and of course I have got to clear the record, the only reason I asked for a weighted ballot is because of the very rigid bylaws that require it, but I was voted down 12 to 7 on that.

Of course, the next time the assessments come due, I am planning on just paying $1 or whatever, just as much as the unions.

Senator TRIBLE. Mr. Chairman, if I could just tie this up, Mr. Hardin, is it your testimony then that if the weighted ballot procedures had been followed as mandated by the bylaws and the tradition of your organization, that the Norfolk Southern proposal would have been accepted?

Mr. HARDIN. I cannot say that. Nobody knows. We did not vote that way. So you know, in all fairness, I am like Dick. I do not know what the vote would have been.

Senator TRIBLE. I am not sure you are being any more responsive now than your colleague to the earlier question.

Mr. HARDIN. Well, you know——

Senator TRIBLE. It was 12 to 7, right?

Mr. KILROY. Senator, I disagree with the count of 12 to 7.

Mr. HARDIN. The record will show that.

Mr. KILROY. There was no record.

Senator TRIBLE. Mr. Chairman, if I could make a request for the record, and then one quick question, Mr. Kilroy is a very artful witness——

The CHAIRMAN. If we could make it quick. We have 12 more witnesses, and it is almost 4 p.m.

Senator **TRIBLE**. The request was made earlier that you gentlemen submit for the record the number of people you represent. I think that would be helpful.

Mr. **KILROY**. The number of each organization, Senator?

Senator **TRIBLE**. Yes.

Mr. **KILROY**. We can do that.

Senator **TRIBLE**. Second, I would request that you submit for us a fair and accurate statement of the proceedings, of how you voted on those proposals. I think we should know how your separate labor organizations viewed these proposals.

[The following information was subsequently received for the record:]

RAILWAY LABOR EXECUTIVES' ASSOCIATION,
Washington, DC, March 6, 1985.

Hon. JOHN DANFORTH,
Chairman, Commerce, Science, and Transportation Committee,
U.S. Senate, Washington, DC.

DEAR SIR: I want to again thank you and the entire Committee for allowing me the privilege on February 28, 1985, to testify on behalf of my membership concerning the Department of Transportation's recommendation to sell Conrail.

During my testimony, the Honorable Senator Trible of Virginia requested information on the voting procedures and results of those votes taken at the special Railway Labor Executives' Association (RLEA) meeting of January 29, 1985, convened to attempt to reach a consensus regarding a prospective purchaser of Conrail.

No official minutes were taken at this meeting, however, from the best of my recollection and personal notes the results of the voting were as follows:

After serious discussions on January 29, spanning many hours, a member made a motion that the RLEA endorse the Alleghany proposal. Another member made an amendment which would include the endorsement of the Norfolk Southern with the Alleghany proposal. The vote on the amendment to include the Norfolk Southern with the original motion to endorse the Alleghany proposal was voted down by a vote of 13 to 5. The vote on the motion to endorse Alleghany was voted down 11 to 7.

A motion as then made to endorse the Conrail Management proposal. The motion was voted down 11 to 7.

A motion was made to eliminate the Marriott proposal. The motion passed unanimously.

A motion was then made to eliminate the Norfolk Southern proposal. The motion was passed 12 to 6.

A motion was made to eliminate the Conrail Management proposal. The motion passed 13 to 5.

Thus, three out of the four proposals were eliminated leaving Alleghany the sole proposal not eliminated.

A motion was again made to endorse the Alleghany proposal. Two amendments to that motion were made by members of the RLEA; both placing certain stipulations to be met by Alleghany before a final RLEA endorsement. Both the amendments and the original motion were passed unanimously.

At an RLEA meeting held on February 12, 1985, convened to vote on the final endorsement of Alleghany, BRAC and ARASA, a division of BRAC, withdrew our support from Alleghany due to my belief that Alleghany did not meet the stipulations placed upon them at the January 29th meeting and because of the subsequent recommendation of Norfolk Southern to purchase Conrail by the Secretary of Transportation. Seventeen other RLEA Unions on February 12th, were a party to a Memorandum of Understanding endorsing Alleghany Corporation as the RLEA's recommendations to purchase Conrail.

Senator Riegle, on February 28th, requested to be provided with the number of employees each Union represents on the Conrail System. The following is a list of active employees represented by each Union as shown in Conrail management's Labor Cost Analysis Average Mid-Month Count—January to December 1984.

1. Brotherhood of Railway & Airline Clerks	8,667
2. United Transportation Union	8,594
3. Maintenance of Way	5,876
4. Brotherhood of Locomotive Engineers	3,080

5.	Transport Workers Union of America	2,105
6.	Brotherhood of Railroad Signalmen	1,607
7.	International Association of Machinists	1,194
8.	International Brotherhood of Electrical Workers	899
9.	Railroad Yardmasters of America	607
10.	International Brotherhood of Teamsters	536
11.	American Train Dispatchers Association	419
12.	International Brotherhood of Firemen and Oilers	398
13.	Sheet Metal Workers International Association	325
14.	Brotherhood of Railway Carmen	320
15.	International Brotherhood of Boilermakers and Blacksmiths	102
16.	International Longshoremen's Association	67

Once again, Senator, may I express my gratitude to you and the Committee for the opportunity to present my union's views on the sale of Conrail.

Sincerely,

R.I. KILROY,
Executive Secretary-Treasurer.

UNITED TRANSPORTATION UNION,
Cleveland, OH, March 6, 1985.

Hon. JOHN C. DANFORTH,
Chairman, Senate Commerce, Science, and Transportation Committee,
Dirksen Senate Office Building, Washington, DC.

DEAR SENATOR DANFORTH: This has reference to hearing on sale of Conrail which you chaired on February 28, 1985 at which I testified on behalf of the United Transportation Union.

You will recall Senator Trible requested I furnish an itemized count of the number of Conrail employees represented by each RLEA affiliate. The current number of active employees can only be furnished by Conrail from their payroll records; however, I am attaching the most recent 12 month average. The midmonth count is the number Conrail furnishes to the ICC and the Railroad Retirement Board which was furnished to the UTU by Mr. William McCain, Assistant to the Vice President of Conrail Labor Relations.

Another request was made by yourself and Senator Ford as to the number of employees and organizations who voted not to eliminate Norfolk & Southern from possible endorsement.

My records indicate the vote to eliminate Norfolk & Southern passed 12 to 7. Based on the attached 12 month average of the midmonth count of employees, the seven (7) organizations voting against the elimination are as follows:

United Transportation Union	8,865
Brotherhood of Locomotive Engineers	3,102
Brotherhood of Maintenance of Way	6,015
Transport Workers Union	2,102
American Train Dispatchers Assn	420
Railroad Yardmasters of America	610
National Marine Engineers	0
Total	21,114

As you will note, the aforementioned figures total 21,114 employees which is nearly a two-thirds majority.

I would like to emphasize that this is not an endorsement of Norfolk & Southern but is only the tabulation of the non-negative organizations you requested.

Trusting this information will assist your committee in its deliberations and thanking you for permitting me to testify, I am

Very truly yours,

FRED A. HARDIN,
President.

Ferlin—ARS	0
Johnson—ATDA	420
Systsma—BLE	3,102
Berge—MofW	6,015
Bates—Signalmen	1,615
Wheeler—Carmen	320

Kilroy—BRAC	8,700
Hanley—Restaurant	0
Peterpaul—Machinists	1,160
Jones—Boilermakers-Blacksmiths	100
Ripp—IBEW	885
Walker—Firemen-Oilers	390
Gleason—ILA	70
Calhoon—Marine Engineers	0
Otto—AYM	610
Stepsay—Sheetmetal	325
Brozak—ISU	0
Hardin—UTU	8,865
Linder—TWU	2,102
Total	34,679

MIDMONTH COUNT OF EMPLOYEES—CONRAIL 1985 BUDGET

	1985 budget	1984 projection	1983
Roadway maintenance—basic	5,362	5,901	6,887
Roadway maintenance—rehab	1,935	2,043	1,677
Total roadway	7,297	7,944	8,564
Mechanical	3,003	3,238	3,193
Car inspection and repair	2,836	2,865	2,941
Train operations—train and engine	10,811	10,796	10,446
Train operations—other than T&E	3,128	3,301	3,493
Total train operations	13,939	14,097	13,939
Stations	2,264	2,337	2,483
Terminals—marketing	199	205	181
Administration—operating	1,232	1,249	1,307
Administration—general	4,750	4,844	5,051
Track abandonment	375	356	147
Additions and improvements	733	731	603
Total freight operations	36,628	37,866	38,409
Passenger	510	523	620
Other reimbursables	524	687	791
Total company	37,662	39,076	39,820

Mr. KILROY. Of course, I cannot speak for the other organizations. I will tell you exactly how I voted on each one.

Senator TRIBLE. Just do that for the record.

Mr. KILROY. I voted against Norfolk Southern, and everybody voted against Marriott. I know of nobody who supported it.

Senator TRIBLE. If you could submit that for the record without doing violence to——

Mr. KILROY. What I was leading up to is, there were no minutes, to my knowledge, kept at that session, only the notes of the individuals.

Senator TRIBLE. But I suspect you all have long memories.

Mr. KILROY. I have better than a long memory. I have someone listening at the keyhole, taking notes.

Senator TRIBLE. Could I just ask one more question? The chairman has said that I can ask one more question. This is moving on to something different. My friends at CSX advocate the convening of a 401 all parties conference to divide Conrail, to divide Conrail up between CSX, Norfolk Southern, and other railroads to achieve a more pro-competitive result.

Would you support that approach? Just yea or nay.

Mr. KILROY. No.

Mr. HARDIN. Absolutely no. Tried to do that in 1981. They just wanted to cherry pick it and scrap the rest. No.

Mr. KILROY. I do not believe that is CSX's position today. The answer is still no.

Senator TRIBLE. Hays Watkins will speak for CSX in just a moment, but that has been a proposal at least advocated by some. You would oppose that?

Mr. HARDIN. I would oppose it because CSX and Norfolk Southern would both want the breast, and someone else would get the wing.

Senator TRIBLE. Or some other part of the anatomy.

The CHAIRMAN. Gentlemen, thank you very much.

The next is a railroad panel—thank you, gentlemen, very much—a railroad panel, Mr. Hays Watkins, chairman and chief executive officer of CSX, Mr. Robert Walker, vice president, Grand Trunk Western Railway, Mr. Robert Neuenschwander, executive vice president, Pittsburgh & Lake Erie Railroad, and Mr. Timothy Mellon, chairman and chief executive officer, Guilford Transportation Industries.

STATEMENTS OF HAYS T. WATKINS, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CSX CORP.; ROBERT WALKER, VICE PRESIDENT, PLANNING, GRAND TRUNK WESTERN RAILWAY; GORDON NEUENSCHWANDER, EXECUTIVE VICE PRESIDENT, PITTSBURGH & LAKE ERIE RAILROAD; AND TIMOTHY MELLON, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, GUILFORD TRANSPORTATION INDUSTRIES

Mr. WATKINS. Mr. Chairman, Senator, I appreciate the opportunity to speak directly on the position of CSX.

The Secretary of Transportation, the Federal Railroad Administrator, and the chairman of Norfolk Southern during the last day and a half have spoken in great quantity on the CSX position. I appreciate the opportunity to correct the record as to what our position is.

Let me say, first of all, though, that I have a statement which I should like to have submitted for the record, a large statement, which, obviously, I will not read.

The CHAIRMAN. All the prepared statements will be submitted automatically for the record.

Mr. WATKINS. Fine. I also have a brief summary of my testimony which I would also like to forego, because I think it is important to cover two subjects. First, to state briefly the CSX position; second, to correct the record on what has been reported to be the CSX position.

Let me say that the sale of Conrail to Norfolk Southern violates every principle of sound transportation policy. It destroys the competitive framework critical to the future health of the rail system in this country.

CSX supports the return of Conrail to the private sector. We have supported finding appropriate ways of having funds returned to the Government for its investment in Conrail. At this stage of the game, we recognize that our so-called section 401 or all parties conference proposal has not been adopted, and does not have widespread support.

I personally have been involved in Conrail and Penn Central and their predecessors for the last 18 years. I am convinced that over the long term, we must find ways to have competitively balanced systems in the East as we have in the South and in the West.

Nevertheless, recognizing reality, we feel that the only viable alternative to the Norfolk-Conrail merger is a public stock offering, and CSX hereby publicly supports a public offering. We have been exploring ways of participating in such an ofering, and have indicated to Morgan Stanley that we would be ready and willing to participate financially.

Let me, though, state the bottom line on the effect of a Norfolk Southern-Conrail merger. I use my words very carefully and very guardedly, but without any reservation whatever. A merger of Norfolk Southern and Conrail will effectively eliminate any meaningful rail competition in the Northeast.

Let me say that again as loudly and as clearly as I can, gentlemen, because this is the essence, in our opinion, of the entire public policy issue. A merger of Norfolk Southern and Conrail will effectively eliminate meaningful rail competition in the Northeast.

I say that without reservation, without qualification. Over the last 35 years of my career in the railroad industry, and the companies with which I have been associated, CSX, Chessie, C&O, I have valued one thing above anything else, and that is my integrity. And so I do not make a statement such as this lightly.

The Federal Railroad Administrator quoted me in his testimony just before the luncheon break. I stand by everything that we have said during prior mergers. We try to be as objective as we can. We try to call them as we see them. There were some terms used yesterday, though, that I think, Mr. Chairman and gentlemen, that I must question, either from the Secretary, the Administrator, or the chairman of Norfolk Southern.

It was alleged that we were afraid of competition. It was alleged that we acted on our perceived self-interest. It was alleged that we are entering into scare tactics, particularly regarding the B&O abandonment. It was alleged that CSX seeks to hold CSX employees hostage, and it was alleged that CSX wants to keep Norfolk Southern out of its eastern markets.

All of these things are patent misstatements or downright errors. As far as being afraid of competition, our railroads, and this witness certainly, were among the foremost, as the chairman knows, in championing deregulation from the late seventies. As far as scare tactics are concerned with the B&O, I assure you these are not scare tactics.

Statistics were quoted to indicate that all Norfolk-Conrail combination will do is to make that combination equal to CSX. With a financial background, I can quote any type of statistics I want to illustrate my point. Let me give you two sets of figures. The results published of the three major rail systems, 1984, Conrail, $500 million; Norfolk Southern $480 million; CSX, $460 million. More importantly, on the rail systems in the Northeast, only the Northeast, the area in question, Conrail, $500 million; Norfolk & Western, to the best of our knowledge, $264 million; the Chessie System, $145.

Eighty-five percent of the profits last year were from the combined Conrail-Norfolk & Western rail system. We have indicated that the potential diversion of traffic from CSX to a Conrail-Norfolk combination is $400 million. We furnished this information to the Federal Railroad Administration and the Department of Transportation last summer without any response whatever.

Let me categorically disagree with the Secretary and the Administrator, who indicates that there have been continuing discussions with CSX. I have met once with Secretary Dole for a very polite 30-minute meeting in her office, but rather than having cooperation with DOT and FRA, it is obvious that CSX has been systematically and purposely excluded from any discussions regarding the future of Conrail.

Now, lastly—I recognize my time is up—let me just say that the B&O part of Chessie System has averaged net income of $26 million per year over the last 3 years. A diversion of $400 million will come largely from B&O. I would defy anyone to tell me how it is possible to have such large diversions of traffic and to avoid the wholesale abandonment of the Baltimore & Ohio Railroad, even if our eventual diversions are only half, $200 million.

What this committee and Congress holds in its hands, let me repeat finally, is, No. 1, the death knell of the Baltimore & Ohio Railroad, the oldest railroad in the United States, and secondly, the death knell to effective rail competition in the east. There is no other conclusion. This is not a threat. This is not a scare tactic. This is economic reality. We have no other choice.

My job is to act, as a steward with fiduciary responsibility to the share owners, 100,000 share owners of CSX, including, I might say, about 25 percent of our employees. I would have no choice except to withdraw from the northeast, and I assure you gentlemen with every sincerity that I have at my command that we not only do not mean this as an idle threat, but if this combination is put together, I can promise the committee that we will do exactly that.

Thank you.

[The statement follows:]

STATEMENT OF HAYS T. WATKINS, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER OF CSX CORP.

Mr. Chairman and members of the Committee, my name is Hays T. Watkins. I am Chairman of the Board and Chief Executive Officer of the CSX Corporation. Our rail subsidiaries, the Seabord System Railroad and the Chessie System Railroads, operate over 26 thousand route miles in 22 states. These two railroads are the principal competitors in the East for Conrail and the Norfolk Southern.

My purpose in being here today is to urge you on behalf of CSX's more than 53 thousand railroad employees and its 100,000 stockholders to reject the proposed sale of Conrail to the Norfolk Southern. I believe this Committee should require the Department of Transportation to find a method of disposing of the Federal Government's interests in Conrail which preserves rail competition and maintains financially viable rail service alternatives for shippers in the East.

I must tell this Committee in the strongest terms possible that the proposed sale of Conrail to the Norfolk Southern violates every principle of good transportation policy and destroys the competitive framework which is the key to the future health of our railroad system. I can think of no action which would be more harmful to rail transportation than the proposed sale to Norfolk Southern. That this process to date has been carried on behind closed doors, with selective and secret negotiations, only compounds the problem.

It is also my purpose today to state CSX's willingness to work with the Department of Transportation and Congress toward a more equitable solution to the problem of selling the Government's interest in Conrail. The Alleghany and the Marriott proposals would each have been acceptable to us, even if not in our view the best solutions. And the public offering of the Government's ownership of Conrail stock remains a fair, reasonable and practical alternative.

CONRAIL AND PRIVATE SECTOR

There is a national consensus that Conrail should be returned to the private sector. It is only because of the collapse of many of our Northeastern carriers that Conrail is now in the public sector, with a minority interest held by the employees. Through the splendid efforts of Conrail's employees and management, and with the cooperation of the states and this Congress, Conrail has struggled back to prosperity.

Conrail has now had three successful years of good and improved earnings. It reported extremely strong earnings for 1984 with a remarkably healthy cash position. Conrail has met the USRA profitability test. This record of accomplishment is a tribute to Mr. Crane and the management team he has put together. But more than that, it reflects the deep commitment of Conrail labor and management to work together to do the things required to make Conrail a going concern. That team work and that spirit are the foundation on which Conrail's new-found prosperity is built, and it provides a strong basis for confidence in Conrail's future.

IMPORTANT QUESTIONS

Our whole tradition of free enterprise now requires that Conrail be placed in private hands. But before that transfer is consummated, there are many questions to be answered. Is now the best time to make the transfer, and are there other and better alternatives? There are questions as to the value of Conrail, and whether it would be better to let the marketplace decide the value or allow a chosen few to set the value. Frankly, to date, many of us, including CSX, have been significantly excluded from the process which has led to DOT's recommendation to sell Conrail to the Norfolk Southern.

These are important questions, of course, but there are even more fundamental questions. How much harm are we willing to inflict upon other railroads, upon rail employees, and upon communities to accomplish this sale? Are we willing to abandon the letter and spirit of the antitrust laws, and to provide a special exemption to those laws? What precedents will be created? Should much of the industrial heartland of the nation be dependent upon one dominant rail system? And what does a Norfolk Southern acquisition of Conrail mean in terms of the ability of the region to attract industry, grow and prosper? And finally, if this transaction is permitted, I also question how long the less regulated environment for railroads created by the Staggers Act will survive.

Personally, I doubt that the Staggers Act, which is predicated upon a competitively structured transportation system, could long survive the creation of such unprecedented market power. I do not believe the American public will accept such a course.

CSX REVIEW

CSX opted for competition and deregulation, and CSX also opted for competition in terms of the sale of Conrail. Early on we realized Conrail would be profitable and, therefore, the sales process would go forward as contemplated by the Northeast Rail Service Act.

We made a carefuly study of a possible purchase by CSX and concluded there would be great benefits to CSX. After all, Conrail is a very significant customer and competitor of CSX, and buying Conrail would eliminate that competition and forever capture the traffic for CSX which now flows from Conrail. We also concluded that very much the same analysis would apply to Norfolk Southern.

THE CONRAIL SALES PROCESS

It only pays to be a monopolist if you can get away with it. Our study convinced us that a CSX or Norfolk Southern proposal to buy Conrail would not survive any rational scrutiny under the antitrust concepts that have governed every railroad merger in this country. We shared our analysis with the Justice Department on several occasions. They apparently agreed with our conclusions. Or at least we thought they did. We came away from these meetings firmly convinced Justice would strongly oppose a sale of Conrail to either CSX or the Norfolk Southern. Obviously, we expected that more analysis would be done by Justice after these preliminary discussions, but we never received any further comments from Justice.

This analysis was also shared with the Department of Transportation, to which we also supplied estimates of traffic that would be diverted from CSX and other carriers if a sale were made to Norfolk Southern. Again, we never received anything from DOT indicating why or where they had differences with our analysis. Frankly, the cavalier indifference of DOT to CSX's good faith offer of information is shocking. Several times we offered to exchange information and our offers were not accepted. At CSX, we were therefore forced to conclude that a thorough analysis of the anti-competitive issue was never made. If analysis was done, it was done behind closed doors and without the debate among the parties with a vital interest in the outcome that should accompany such a major transaction. If DOT believed our analysis, it is inconceivable they could choose Norfolk Southern. If they did not believe it, I have to believe the responsible way to proceed would be to sit down and find out what were the true facts.

Because of the anticompetitive problems of a purchase by either major competing rail system, CSX proposed that the Secretary call an all-parties conference to restructure Conrail between CSX, NS, and the other railorads in a procompetitive way.

The members of the Committee will recall that in 1976 the Congress gave to the Secretary explicit authority to convene a conference of railroads and other interested parties to discuss unifications and coordinations and to give participants in these discussions antitrust immunity under Section 401 of the Regional Rail Reorganization Act (the so-called 4-R Act, P.L. 94-210; Section 401 now appears as 49 U.S.C. 333).

The 4-R Act was the enabling legislation that allowed Conrail, a railroad itself constructed from the forced coordination and unification of the Penn Central and four other bankrupt lines in the Northeast, to begin operations in April, 1976. The Congress wisely granted the Secretary of Transportation broad power to encourage further rationalization of the railroad system. It is quite clear that this authority could have been properly used in 1984 to bring about the orderly disposition of Conrail and its return to the private sector where it belongs. We believed it was a legitimate way to proceed.

Under our proposal, the Secretary would not have been bound to accept all the results of the 401 conference would have provided another proposal to evaluate. Despite some private encouragement from DOT and Justice, DOT publicly seemed to do everything possible to avoid a 401 conference, arguing the Secretary did not have the authority to hold such a conference, which clearly misreads both the statute and congressional intent, or that such a conference was inconsistent with NERSA, which was also not the case. The irony in all of this, of course, is the DOT has now undertaken a mini-40 conference with the regional carriers, Guilford, P&LE, and GTW, and is itself proposing a partial dismemberment of Conrail. We were told by DOT that they could not proceed with our 401 proposal because partition of Conrail violated the requirements in NERSA that Conrail be sold as an entity. In partitioning Conrail, DOT itself is violating the requirements that Contrail be sold as an entity.

Looking back at the course of events, I believe there are serious questions as to whether the sales process farily explored all the alternatives and presented all the facts to the American public and the Congress. I do not believe it is too late to open that process.

CSX OPPOSITION

We will continue to adamantly oppose the sale of Conrail to Norfolk Southern. We must do this because of the interests of our employees and shareholders. But we also deeply believe that such a sale would be totally contrary to the public interest. If Norfolk Southern is allowed to purchase Conrail and we do not take protective steps, the CSX railroads will lose considerable revenue. To protect ourselves we will have to abandon several thousand miles of track; and the jobs of several thousand employees will be wiped out. The same severe economic impact will be felt by other regional railroads. Our analysis shows that substantial traffic will be diverted from currently profitable railroads such as the C&NW and the ICG.

ANTICOMPETITIVE ASPECTS OF NORFOLK SOUTHERN SALE

Besides these impacts on other railrads, a sale to Norfolk Southern will produce a drastic reduction in competition and service.

By our initial count, dozens of counties in Ohio and Indiana would find themselves totally captive to the Norfolk Southern/Conrail combine. In many other counties the combined railroad would become the over-whelmingly dominant force. Other counties and areas would have only the minor presence of a second carrier. The Justice Department, which we believe understates the problem, points to 39 counties in 21 states where competition would be severely reduced. We believe the problem may affect approximately 200 counties.

A combined Norfolk Southern/Conrail would dominate major traffic flows in an area bounded roughly by Buffalo and Pittsburgh in the East, and Chicago and St. Louis in the West. It will have a pervasive and negative impact on the transportation of such industries as steel, auto and auto supplies, chemicals, coal, electric utilities, machinery, paper, and construction materials.

NEW YORK/TEXAS CORRIDOR RAIL TRAFFIC

A merger of Norfolk Southern and Conrail would also perpetuate the near monopoly of traffic that Conrail now has east of the imaginary line that would connect Buffalo, Harrisburg, and Philadelphia. When Conrail was originally set up in the 1970s, the Department of Justice testified in opposition to its structure because of the severe anticompetitive effects in this eastern region. But the situation was desperate and Conrail was established in its present form. The situation is no longer desperate.

Recently, the Justice Department issued its long-awaited report on the effects of a Norfolk Southern/Conrail merger. The central and unmistakeable thrust of the report is that a merger of Norfolk Southern/Conrail will have a "very serious anticompetitive effect." Even though those are harsh words, I believe they significantly understate the problem.

I must say initially that we have not been allowed to see the supporting material for the report or to question in any way the Justice staff who prepared the report, as would have occurred in any ordinary proceeding. But even with these handicaps, any fair appraisal must find the report seriously deficient. The Justice report only deals with the worst of the worst (and yet still identifies 100 problem markets). It ignores, contrary to past Justice testimony, the area east of Buffalo, Harrisburg, and Philadelphia; underplays the significant potential for anti-competitive conduct at the major gateways to the Conrail/Norfolk Southern monopoly territories; and further ignores how the loss of competition would spread over time as CSX and other carriers in the region are forced to abandon service to many markets.

Let me go into a few of these points in somewhat greater detail. The Justice Department ignores areas where Conrail presently has a monopoly. Perhaps their reasoning is that a sale to Norfolk Southern will simply preserve the status quo in these monopoly areas. When Conrail was set up in the late 1970s, Justice argued against this government-created monopoly and urged a more procompetitive approach. I should also add that in the merger which resulted in the Penn Central, the Justice Department urged that the Pennsylvania Railroad (the procedecessor to Conrail) and the Norfolk and Western (the predecessor to Norfolk Southern) be separated. Somehow these earlier positions have been forgotten.

But the real problem is that a sale to Norfolk Southern does not just preserve the "status quo" in these monopoly areas. Conrail today takes traffic to Chicago, and then chooses among a whole series of carriers on the basis of route efficiency as to who should continue with the traffic to the West. After a merger of Norfolk Southern and Conrail, the traffic will move only on Norfolk Southern to the Kansas City gateway.

Conrail traffic now moves south via Norfolk Southern and CSX, again on the basis of efficiency and service. Once there is a merger, all that traffic will move south on Norfolk Southern. Norfolk Southern will have an incentive to squeeze CSX out of the routings by closing routings to CSX and systematically favoring the NS long-haul routing. This will deny customers the option of competitive service, and most importantly, this problem will spread. As traffic is diverted from other carriers, it will call into question the viability of those lines, and lines will have to be abandoned, thus forever denying an ever-broadening base of customers a competitive alternative. Thus, a sale to Norfolk Southern is anticompetitive in at least 5 ways: (1) competition is reduced from two to one major carrier in significant areas; (2) in many other markets, Norfolk Southern/Conrail becomes the dominant presence; (3) the monopoly Conrail has in the East is perpetuated and Norfolk Southern is allowed to use the Conrail monopoly to extend its monopoly power into other markets; (4) geographic or source competition between Conrail and NS will be eliminated; and (5) other carriers over time will withdraw from markets, further reducing competition.

The Justice Department only addressed the first of these issues, and even here the analysis is lacking. It is deficient because Justice has only looked at the "worst" markets and ignored others. But even where they looked at the worst, their solution is woefully inadequate. I understand the Secretary of Transportation has said where there are two carriers in the Norfolk Southern/Conrail overlap territory, there will continue to be two carriers. But who will be the carrier to replace an independent Conrail? Conrail is a competitor of CSX. I may not like that competition. But it is very real and very strong. Will the PL&E provide that same competition—next year and five years from now? Guilford is struggling today. Can anyone seriously contend that it will provide shippers the same options and the same market competition which they enjoy today? Several years ago an attempt was made to strengthen the D&H (part of Guilford) by extending its lines. The result, however, was a longer, weaker carrier. Guilford was rejected as a purchaser of Conrail because of a lack of resources. Why can it now be a competitor? The Secretary is worried about the uncertainty of a free-standing Conrail. Why is she not worried about the uncertainty of competition from the PL&E, or Guilford, or GTW? The net earnings for 1984 of all these carriers are not yet into double digits. See attachment.

DOT's decision to choose Norfolk Southern is apparently based upon its concern over the viability of an independent Conrail. Given Conrail's performance over the last several years and the strong management team in place, DOT's views are certainly subject to serious questioning. But if DOT is concerned about Conrail's viability, how much greater must the concern be over the viability of mini-carriers and the P&LE who will have to compete against the combined power of the merged Norfolk Southern/Conrail system?

ALTERNATIVES

Are there alternatives to a Norfolk Southern purchase? We proposed a 401 all-parties conference. Because of the selective and secretive negotiating format of DOT, that proposal has not even reached the negotiating table to date. We have no idea how many other reasonable alternatives have been rejected out of hand. CSX for its part will support and aid any reasonable proposal, be they the Alleghany and Marriott proposals, or a properly structured public offering.

Questions have been raised about a public offering, but I think they can all be answered. Covenants can apply to a publicly held Conrail just as they can apply to a Conrail held by another entity. [Frankly, the covenants in the Norfolk Southern memorandum are so vague as to be worthless.]

Those covenants can be placed in the implementing legislature. Norfolk Southern is a publicly held corporation and so would Conrail be. And the managements of both companies are known. Therefore, I do not understand the Secretary's concern about selling Conrail to the unknown public or about who will manage Conrail.

In terms of the size of the offering, $1.2 billion transactions are not extraordinary events in the financial market. In fact, CSX recently was involved in a transaction of at least that magnitude. If some of these earlier stock offerings are adjusted to present-day dollars, I do not believe the $1.2 billion figure is particularly remarkable. Let me remove some of the "uncertainty."

CSX is exploring ways to participate in such an offering, and I believe that once our intentions are known, there will be other railroads who would want to participate.

We are also willing to enter into negotiations with a free standing Conrail to exchange track or trackage rights in such a manner as to strengthen *both* systems—ours and Conrail—and to provide new competitive service. I believe such an arrangement would work, with CSX obtaining track to New York and thus opening New York and New Jersey to keen competition, and at the same time opening CSX track to Washington to Conrail. As I indicated, we will enter into such an arrangement with any sensible alternative—whether it be a public offering, Marriott, or Alleghany—that preserves competition and service.

Mr. Chairman, many times it takes the utmost courage to admit that an originally well-intentioned plan of action is not correct and to reverse its course. I would hope this Administration would recognize that the initial course chosen is not correct. We stand ready to work with them and this Congress to perfect a Conrail solution that assures viable rail service in the Northeast in the long-term and which maintains the highest level of competition. To continue on the present course would be to opt for an anticompetitive solution that would forever foreclose a rational and competitive national rail system.

A MERGED NORFOLK SOUTHERN-CONRAIL WILL DWARF POTENTIAL ACQUIRING CARRIERS

[Carloadings in thousands; dollar amounts in millions]

	Carloadings	Revenues	Net income
Railroad:			
Conrail	1,846	$3,380	$500.2
Norfolk Southern	2,775	3,520	482.2
Contrail/NS	4,621	6,900	982.4
Grand Trunk Corp	230	405.9	10.9
Guilford Transportation [1]	60	189.0	5.0
Pittsburgh & Lake Erie	64	48.0	(11.6)

[1] First 9 months. except carloadings. Includes B&M and D&H.

The CHAIRMAN. Mr. Walker.

Mr. WALKER. Yes, Mr. Chairman. I represent the Grand Trunk Western, and I would like to apologize for my president today, Mr. John Burdikan, who is in the Orient on business and is unable to be here today.

The Grand Trunk's position, we feel very comfortable actually in many instances we are not as closely allied with the larger carriers in the East as we are here today sitting next to Hays Watkins. We as a regional carrier also oppose the acquistion of Conrail by NS.

Grand Trunk Western is a regional carrier, and there have been a number of references today to regional carriers. We serve the key Midwest markets and the industrial centers of Michigan, Ohio, Indiana, and Illinois, and we are convinced, as is Chessie, that this transaction will unacceptably reduce competition and severely harm regional carriers such as Grand Trunk.

Stated very simply, we are at the present time and have been in the past a very effective competitor against a very large system, Conrail within the State of Michigan and the region which we serve. In that regard, we have had a friendly connection which got us beyond the region which we serve, and that was NS.

As a result of this transaction, NS and Conrail combining, we will have lost our friendly connection, and as a result, after very careful study, it is very evident to us that we simply will not survive as an effective competitor, and perhaps not even as an effective company in the region.

We estimate, based on our study, and I think that our—the documents that we filed here today with you will confirm this, that we will lose somewhere around 35,000 to 52,000 carloads to this system if it is consummated. That amounts to some $25 or $30 million.

For a company that in a very good year of recovery only had net income of some $3.3 million, you can visualize what the impact of that loss of gross revenue will be to our company. There is a significant secondary effect, obviously, which is primarily felt in the area which we serve where our lines operate, and that is on employees, and on the service which we will be able to provide. It will be significantly reduced, and obviously there will be significant impacts on employees.

There is, and I think Mr. Riley mentioned it some time either today or yesterday, that there was significant concern by DOT to protect the regional railroads in some fashion. One of the protections that I understand that were being considered, that are being considered is the question of opening up and ensuring that regional railroads left within the region will have open gateways with the new Conrail-NS system.

Unfortunately, it appears that particularly Grand Trunk, which had gross revenues last year of $340 million, has been excluded from that measurement, as I understand, that they have fixed or suggested a minimum—a maximum, excuse me, gross revenue of somewhere in the neighborhood of $300 million, and unfortunately Grand Trunk as a regional railroad is excluded based on that measurement.

There have been suggestions here that a divestiture is the solution to the anticompetitive impact. In fact, we had been very much involved in a proposal called prorail, which was an effort to attempt to set up what we consider to be at least the minimum necessary to provide a competitive alternative to NS.

That prorail proposal was not acceptable to NS, nor was it to DOT, based on the discussions that we had when it was presented to them. In fact, Secretary Dole's characterization of our involvement, I think, was somewhat inaccurate, in which yesterday she mentioned that GTW was not willing to include any of the other regional carriers such as GTI or Guilford Industries, which GTI refers to.

We in fact in our proposal suggested that we include all of the regional carriers in a divestiture program in an effort to try to create a competitive alternative. She also indicated that we were unwilling to negotiate or consider other lines. We were very much willing to consider any lines, although we did have some concern that the lines being offered, which were primarily being suggested by NS, the proponent of the aquisition, were not adequate and would not provide a competitive alternative to their operation.

It is not surprising that NS certainly would not want to create an effective competitor, and it was quite evident that the lines they were suggesting would not do that.

So, I fear that GTE's situation in regard to its willingness to negotiate was simply based on options that were being offered to us but were unacceptable and would not do the job in providing the competition which everyone seems to be involved in here, with the concern that it will be solved by this particular divestiture which DOT and NS, P&LE, and Guilford have agreed to.

We feel that these lines that have been suggested, that have been agreed to by P&LE and Guilford, will not come close to providing the competitive alternatives that are needed to even in any way alleviate the anticompetitive problems associated with this transaction.

Somehow or other, I believe that there has to be an objective review, either through a body such as USRA, or some other objective body that can review the alternatives, one being the prorail that has been suggested by Grand Trunk and P&LE at one time, and also now the DOT's suggested divesture which P&LE, Guilford, and NS maintain meets the Justice Department's criteria.

[The statement follows:]

STATEMENT OF ROBERT A. WALKER, VICE PRESIDENT-PLANNING, GRAND TRUNK WESTERN RAILROAD CO.

I would like to thank the Committee for providing the Grand Trunk Western Railroad Company (Grand Trunk) with this opportunity to comment upon the Conrail sale process and the proposal by Secretary Dole to sell the government's interest in Conrail to the Norfolk Southern Corporation (Norfolk Southern or NS).

Grand Trunk will be severely impacted by a Norfolk Southern-Conrail merger, as will be those shippers and communities in the region that depend upon competitive rail service. The only hope for Grand Trunk and for those shippers dependent upon preservation of competitive transportation alternatives was the divestiture plan mandated by the Department of Justice as a condition to the Norfolk Southern transaction. Unfortunately, events of the last several days raise considerable doubt that a careful and objective assessment has been, or will be, undertaken to determine whether such a plan is viable or whether the system created from the divested lines of Conrail and NS will provide adequate competition to counterbalance the market power of the NS-Conrail system.

Grand Trunk believes, based upon what it knows about the deal announced by DOT, that the divestiture plan will not work and cannot survive the scrutiny of objective analysis. An independent investigation by an agency with transportation planning expertise—yet without a stake in promoting the NS-Conrail transaction—is critical because the Norfolk Southern acquisition should not go forward unless it can be clearly demonstrated that the divestiture plan satisfies the criteria established by the Department of Justice. The rail system of the Midwest and Northeast will be restructured through the Conrail sales transaction, and Congress must not approve a structure that will eliminate competition or endanger the essential services provided by regional carriers.

In order to place our position on these issues in clearer context, I think it would be useful to explain the plight of regional midwestern carriers and why it is essential to insure that competition and the National Rail Transportation Policy not be sacrificed simply to achieve a hasty disposition of the government's Conrail stock.

THE VITAL COMPETITIVE ROLE SERVED BY REGIONAL CARRIERS

Regional carriers serve essential competitive roles in the key industrial markets of the Midwest. Grand Trunk operates over 1,500 miles of railroad in Michigan, Ohio, Indiana and Illinois, and directly employs over 4,000 in that region.

Historically, Grand Trunk and other regional carriers provided competition to the giant rail systems by participating in joint line movement of freight between the markets they serve directly and those beyond the reach of their lines. These joint line movements among regional carriers and their friendly connections provided efficient, competitive transportation alternatives for shippers to the service rendered by the larger rail systems.

Preservation of this form of indirect competitive access to markets served exclusively by the giant rail systems was a fundamental premise that permitted the creation of Conrail in 1976. USRA initially rejected on competitive grounds the creation of a monolithic Conrail system out of the bankrupt Northeastern carriers. However, when USRA sponsored alternatives proved impractical, it approved the monolithic Conrail structure, but only with the understanding that indirect access to shippers and markets would be preserved.

That was to be acheived through a series of contracts between Conrail and the regional carriers, that provided for the maintenance of joint line routes and rates applicable to those routes. Reciprocal switching at reasonable levels in markets jointly served by Conrail and its competitors was also presumed to offer competitive alternatives to shippers served directly only by Conrail.

While competition initially flourished between Conrail and the regional carriers, in recent years the regional carriers have been fighting the competitive battle on a playing field that has been tilted unfairly against them, and in favor of the giant interterritorial rail systems such as Conrail. The mechanisms for preserving competition envisioned by USRA have been gutted through misguided regulatory policies at the Interstate Commerce Commission. For instance, Conrail was permitted to abrogate the contracts just described that were to preserve routing alternatives via regional carriers.

Competition in the Midwest and Northeast has been placed in jeopardy. The two most significant factors leading to this result are the regulatory philosophies that: (1) permit the concentration of rail assets and market power through the approval of giant rail mergers that joined formerly friendly connections to the regional carriers with their competitors; and (2) encourage these rail megasystems to foreclose, by rate cancellations and route closings, the competitive access regional carriers depended upon to gain access to the national rail network and the shippers they served via joint line routes.

The sale of Conrail to Norfolk Southern proposed by Secretary Dole further threatens existing rail competition in the Midwest and Notheast. Absent adequate precautions, this transaction will also deal a devastating blow to the regional carriers, like Grand Trunk, from which they are unlikely to recover. Shippers will see their transportation costs increase as the restraining force of competition provided by these regional carriers disappears. The job of those employed by regional carriers will be jeopardized if the sales transaction results in a rail structure that prevents those carriers from competing.

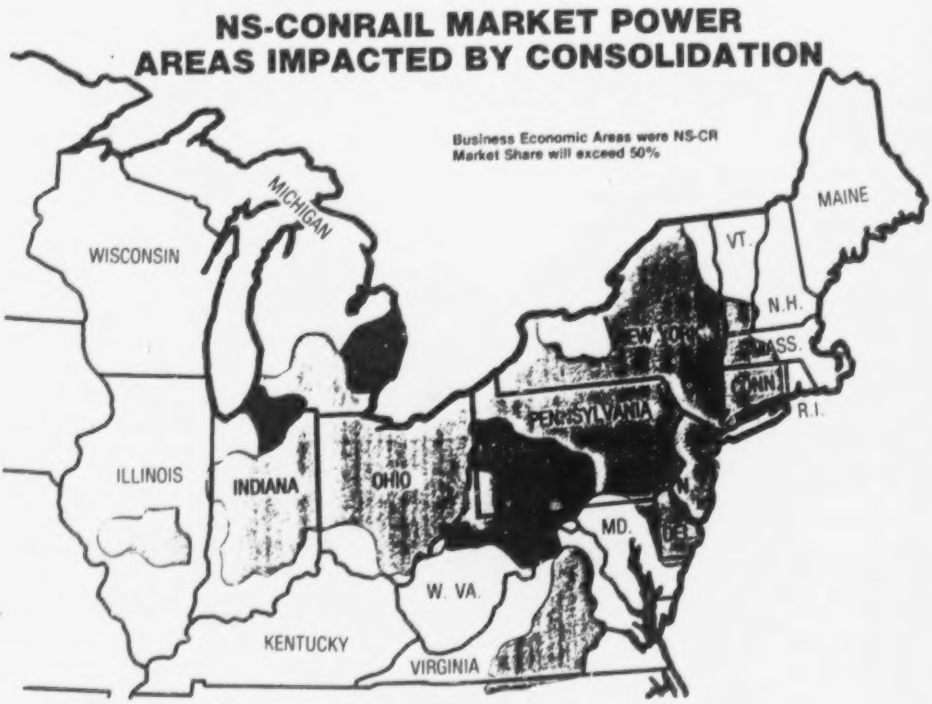
The sales transaction should also be viewed as an opportunity to rectify the shortcomings of recent regulatory policy. At a minimum, the rates and routes cancelled by Conrail should be reestablished through a mechanism that permits regional carriers to quote rates to markets formerly served over joint line routes on a basis that is fair to the owner of Conrail. Such a condition on the sales transaction would permit shippers and the marketplace to decide how traffic is routed, rather than NS-Conrail management.

NORFOLK SOUTHERN'S ACQUISITION OF CONRAIL THREATENS COMPETITION

Strong medicine—not a weak palliative—is essential for the preservation of vibrant competition in the wake of a Norfolk Southern-Conrail merger. This merger will create a rail system of unprecedented size and market power. The combination will result in the largest transportation enterprise in North America with combined annual revenues of about $7 billion. NS-Conrail revenues will exceed the combined revenue of the eight largest motor carriers, one of which (North American Van Lines) is also about to be acquired by Norfolk Southern. The combined system will blanket a twenty-three state area with a network of 32,000 miles of railroad. There will be over 5,000 stations on that system which are served by no other railroad and to which competitive access can be foreclosed at the whim of the NS-CR management.

The focus of much of the competitive analysis to date has been the area west of Buffalo and Pittsburgh and east of Chicago and St. Louis where the Conrail and Norfolk Southern systems overlap and compete directly at stations they jointly serve. Although significant impacts will be felt in that region, the perspective should be expanded because both carriers compete with each other indirectly over joint routes involving the regional carriers. For instance, Grand Trunk participates in movements in and out of Michigan in conjunction with NS which are directly competitive with Conrail movements. Once the merger occurs, that competition will also cease.

The anti-competitive impacts of this merger will be felt beyond the areas defined by the Department of Justice in its analysis of the NS-Conrail consolidation. I have brought with me a map depicting the areas (Business Economic Areas or BEA's) in which the merged carriers will secure market power as measured by the percentage of total rail traffic originated or terminated. The shaded areas include all BEA's in which the NS-Conrail market share will exceed 50 percent of all traffic. The blue shaded areas represent a straight historical analysis of 1983 traffic, that combines the traffic each handled during that year.



NS-CONRAIL MARKET POWER
AREAS IMPACTED BY CONSOLIDATION

Business Economic Areas were NS-CR Market Share will exceed 50%

MAINE
VT.
N.H.
MASS.
CONN.
R.I.
NEW YORK
PENNSYLVANIA
N.J.
DEL.
MD.
MICHIGAN
WISCONSIN
ILLINOIS
INDIANA
OHIO
W. VA.
KENTUCKY
VIRGINIA

← 26½ pi →

That form of static analysis shows only a portion of the impacts, however. The two carriers, once merged, will be able to do things together that neither could do alone in 1983. An iterative analysis, which takes into account the additional traffic diversions which will occur as a direct result of the merger, is the accepted method for measuring these impacts in merger proceedings at the Interstate Commerce Commission. The Department of Justice specifically declined to review these impacts in its evaluation of the merger. The trouble with disregarding such impacts is that the analysis assumes that regional carriers will continue to serve as a restraining force in markets where they historically played such a role. In fact, the traffic diversions resulting from the merger may so weaken them that they will be prevented from continuing to offer truly competitive service in those markets.

Grand Trunk looked at its own traffic data to perform a preliminary analysis, and the areas shaded in red show the additional areas where NS-Conrail will gain market power. This depiction is not comprehensive because it does not take into account the impacts the consolidation will have on all carriers. Grand Trunk does not have access to that data, but the government does and the analysis should be performed.

I would like to comment on two aspects of the Department of Justice analysis: (1) the process by which the Department reached its conclusions and (2) the validity of its basic recommendations. Justice actively solicited the comments of shippers, state governments and affected carriers. Grand Trunk participated in that process, prepared several studies and was invited to meet with the staff to discuss and explain its views.

The process at Justice had one serious flaw, and it is a comment that applies with even greater force to DOT. The submissions and studies performed by proponents of the NS acquisition, including DOT, have not been made available to affected parties for review or comment.

When critically important issues of public policy are being decided by the government, I believe that the public benefits from the adversary process where all affected parties know, and are permitted to comment upon, the facts upon which the government is being asked to base its decision. The Departments of Justice and Transportation have withheld this information because it allegedly contains commercially sensitive data. However, identical data are routinely disclosed to parties to merger proceedings at the ICC, subject to appropriate protective orders. As a result of this policy of nondisclosure, a Freedom of Information Act request was denied by DOT for information fundamental to analysis of the Norfolk Southern acquisition, including essential information relating to the manner in which Norfolk Southern intends to operate the combined NS–Conrail system.

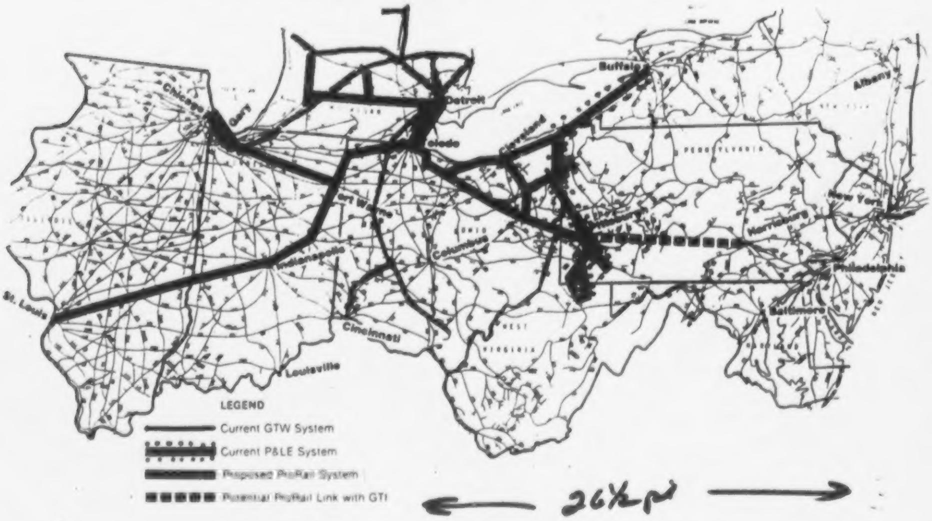
On the merits of Justice's analysis, Grand Trunk believes that they correctly identified some, but by no means all, areas of competitive concern raised by the merger. In addition to the limitations of a static traffic analysis already identified, we are concerned that Justice excluded markets from consideration based upon criteria which do not assure that adequate competition will be preserved in those markets. These are technical matters and our attorneys and consultants will be available to explain our specific reservations with members of your staff.

REQUIREMENTS FOR DIVESTITURE AND THE NEED FOR A TRULY COMPETITIVE RESPONSE

Less than twenty years ago during the Penn-Central merger proceedings, Justice asserted that an affiliation between the Pennsylvania Railroad (PRR) and the Norfolk and Western Railroad (N&W) created an unacceptable concentration of market power in the region, and that PRR should be required to divest its controlling interest in the N&W. The ICC agreed and ordered the divestiture. Much has happened in the intervening years, including a dramatic reduction in the number of independent rail competitors throughout the Northeast and Midwest. However, approval of a consolidation that links N&W's even larger successor (Norfolk Southern) with PRR's successor (Conrail) is more offensive to the principles underlying the antitrust laws today than it was during the earlier proceeding.

This time Justice has recommended a divestiture plan that is more limited than it required twenty years ago. Nevertheless, the Department wisely has set critieria for a divestiture plan similar to those DOT applied in evaluating the bids for purchase of Conrail. That is to say, a new rail system, which is capable of providing true competition for NS–Conrail, must be fashioned from the divested lines. Beyond simply linking the impacted markets identified by Justice, the new system must also be viable for the long-term, and must demonstrate that it has the managerial, operational and financial capability necessary to compete. Justice further required that all alternatives be considered by DOT, and reasons supplied for why they were rejected.

PRORAIL
COMPETITIVE ALTERNATIVE


Chicago
Gary
Detroit
Toledo
Cleveland
Buffalo
Albany
PENNSYLVANIA
New York
Pittsburgh
Harrisburg
Philadelphia
Baltimore
Fort Wayne
Columbus
Indianapolis
St. Louis
Cincinnati
Louisville
OHIO
WEST VIRGINIA
LEGEND
Current GTW System
Current P&LE System
Proposed ProRail System
Potential ProRail Link with GTI

← 26½ pi →

Grand Trunk believes that the ProRail proposal which it has advanced satisfies these criteria. I have brought a second map which depicts the routes over which ProRail would operate. Grand Trunk remains convinced that only a system of high quality lines with access to significant rail markets has a chance of competing with NS–Conrail. Grand Trunk continues to support the ProRail concept. Unfortunately, the ProRail proposal has not received serious or detailed consideration at DOT because Norfolk Southern simply has been unwilling to discuss divestiture of certain of the lines critical to that ProRail's viability. DOT has been working in tandem with its chosen buyer, Norfolk Southern, to put together "package deals" which have the appearance of satisfying the DOT's requirements. With DOT acting as a proponent, rather than an unbiased quardian of the public interest, it is impossible for the ProRail proposal to receive serious consideration by Norfolk Southern. Norfolk Southern has no incentive to consider divestiture of anything beyond its weakest lines in the impacted corridors. Norfolk Southern has placed alternative properties on the table for negotiation, but after an on site inspection by our operating personnel and expert consultants, we have determined that a system comprised of those lines cannot provide a competitive level of service or be operated profitably.

If reports received during the past several days are correct, other regional carriers have decided to accept what Norfolk Southern has offered as means for improving their own structural and commercial inadequacies. Our preliminary analysis indicates that they cannot succeed in providing a truly competitive counterbalance to the NS-Conrail system, but we have to learn more about what these carriers propose. It is apparent, however, that instead of structuring a proposal which accommodates the interests of all affected regional carriers, DOT has decided to endorse a system against which Grand Trunk will be forced to compete. This competition rather than coordination—among regional carriers will further detract from the viability of the system established to compete with NS-Conrail.

The crucial question and the concern which this Committee and the Congress should address is whether the divestitutre program supported by DOT and NS will receive the careful and objective scrutiny it requires. The structure of the rail network in the Midwest and Northeast will be shaped by the Conrail sale transaction. The shipping public will pay the price if through precipitous selection of a particular structure, without adequate evaluation of alternatives, regional carriers are no longer able to compete against NS-Conrail. Once extinguished, it will be next to impossible to rekindle rail competition in the region.

Grand Trunk is very concerned that the process upon which DOT has embarked will not provide the independent assessment of the alternatives necessary to assure that the Justice Department criteria are satisfied, and the public interest is served. DOT has become an advocate for the NS-Conrail consolidation, and is extremely anxious to see that transaction promptly consummated. If the necessary and appropriate competitive fix under the Justice criteria is unacceptable to Norfolk Southern, DOT cannot be counted on to insist upon that result. DOT's quick endorsement of the deals negotiated in the last few days among Norfolk Southern, the Pittsburgh & Lake Erie Railroad and the Guilford System indicate that no serious or objective study will be performed by DOT.

Justice, on the other hand, does not have the transportation expertise to evaluate the operational feasibility of the various proposals to determine whether the lines selected are adequate to the task of creating a viable competitor, or whether the traffic assumptions upon which the business plans are based are reasonable.

Grand Trunk has disclosed its plans and studies to all who have inquired, but there has been no ability to obtain information about the competing proposals to determine whether they can stand the test of public scrutiny. We believe that those who think that the divestiture plans negotiated over the last several days satisfy the criteria established by the Department of Justice should be obligated to disclose the data and studies which support a conclusion.

Grand Trunk earnestly requests that Congress designate an independent agency to review the divestiture plan proposed by NS and DOT, as well as the alternative plans, in order to assure that the Justice Department criteria are satisfied. That agency must possess not only transportation expertise, but also an unimpeachable independence from the Norfolk Southern proposal. It must also be prepared and empowered to reject the basic transaction pending creation of a viable competitive system.

CONCLUSION

Grand Trunk opposes sale of Conrail to Norfolk Southern unless the process can be placed on a course that will assure that an objective assessment will be made that the market power of NS-Conrail can be effectively counterbalanced by a competitive, operationally and financially viable alternative system. That system must provide efficient access by impacted regional carriers to shippers and markets from which they are threatened to be foreclosed by the NS-Conrail transaction.

Grand Trunk is confident that these objectives can be achieved, provided a careful analysis is not sacrificed for a quick closing of the sales transaction. The structure of the rail network for the eastern half of the United States will be decided during the course of these deliberations. The high barriers to entry into the rail industry prevent reestablishment of rail competition once it is eliminated. The structure decided upon here must insure that natural market forces will be permitted to operate in a competitive environment that ensures the provision of efficient, low cost rail service. Congress and the Administration cannot afford to permit this opportunity to pass.

The CHAIRMAN. Thank you, sir.

Mr. Neuenschwander.

Mr. NEUENSCHWANDER. Thank you, Mr. Chairman.

I am the executive vice president of the Pittsburgh & Lake Erie Railroad headquartered in Pittsburgh, PA. It is one of the two regional carriers that the Secretary announced would be involved in the divestiture program under the NS purchase of Conrail.

As a bit of history and background, the P&LE was created precisely to meet competition over 100 years ago. It was built in order to link with the New York Central Railroad Co. to offset what was regarded as the competitive stranglehold of the Pennsylvania Railroad in that very important industrial region of western Pennsylvania and northeast Ohio. Throughout the first 100 years during which it was a corporate subsidiary of the New York Central, the P&LE had operated at a very profitable level and thrived upon large movements of iron ore, coal, and many bulk products throughout that important region of the country.

The merger came about between New York Central and the Pennsylvania Railroad in 1968. After that, the properties of Penn Central were taken by the Government in 1976 and formed Conrail which we are now considering to return to the private sector.

P&LE was not included in 1976 in that transfer. Instead, it was retained by the Penn Central, and later sold in 1979, fairly recently, to private owners. In 1973 and 1974, the USRA that was involved in the creation of Conrail envisioned a Conrail that did not look like it really does today. It was to be somewhat smaller, and other, larger carriers were invited to provide a competitive solution to the situation.

That did not come about. The alternative was to leave a large Conrail, but rely upon, as USRA indicated, a strengthened regulation situation, if necessary, to control the anticompetitive situation.

That was 9 years ago. Since then, rather than more regulation, the world has turned around in the railroad industry, and we have less regulation. Instead Conrail has, as a beneficiary, and advocate of the Staggers Act, adroitly exploited those newfound powers with a vengeance. It has come in hard on carriers such as the P&LE, which is completely surrounded by Conrail and the other two large carriers in the East, the Norfolk Southern and CSX.

Conrail, in particular has, contrary to what we heard this morning, effectively shut out the P&LE from gateways which it had enjoyed and relied upon with its former friendly corporate parent, Penn Central, but now is a strong competitor under Conrail. It had interfered with service on occasion which hurt the P&LE, and these anticompetitive activities have been especially devastating to the P&LE in these recent years.

P&LE presently operates perhaps the largest fleet of railroad cars among the smaller regional carriers in this country. We have a great investment in that, and we have a great burden of debt to support that, but we are not now able to utilize this tremendous railroad investment that was made.

In spite of the economic hardships that were caused by the downturn in our industry in the Pittsburgh area, and the anticompetitive and unfair competitive practices that we think that Conrail has engaged in, P&LE has survived. Our employment, however, has shrunk in half in the past 5 or 6 years. We came down in about 6 years from 2,200 employees to the 1,000 employees that Mr. Riley mentioned morning, and not one of those employees received any severance payments except from our own pocket. All of those employees have suffered loss during this period of time when Conrail, on the other hand, has seen its fortunes go up.

Since Conrail's formation, the P&LE has had to rely substantially upon the Norfolk Southern as a friendly east-west connection, replacing the old New York Central. In 1983, for example, about 27 percent of our interline revenue is derived from joint hauls with the Norfolk Southern in movements which were competitive to Conrail in single line hauls.

This revenue, the competition which it represents and the very future of the P&LE and its customers and employees will be placed at great risk by the combination Norfolk Southern and Conrail. Now, we find that the combination has been cleared by DOJ under certain conditions with the divestiture program which it has outlined.

We were gratified by the actions of the Secretary of Transportation and the Administrator, John Riley, who had recognized the need for, and the role of regional railroads, including the P&LE, to be a part of this divestiture process. Representatives of the Norfolk Southern had stated that they will embrace the conditions of the Justice Department's letter. For our part we have been able to negotiate with Norfolk Southern an agreement in principle that will have the P&LE acquire about 400 miles of new lines which will place it in new markets and reach new connections with other regional carriers such as the Grand Trunk and the Guilford Transportation System.

This course of action, we feel, is a breakthrough for us. This breaks us out of the isolation which the Secretary had indicated we were stuck with. We cannot appear before you today and say that we are perfectly, 100 percent satisfied with this solution, but it is a giant step in the right direction.

We do support the combination of Norfolk Southern and Conrail, provided the conditions of the Department of Justice, as outlined in the January 29 letter, are fully implemented.

I thank you for the opportunity to present our views as a small regional carrier that is particularly concerned about the outcome of this important transaction.

Thank you very much.

[The statement follows:]

STATEMENT OF GORDON E. NEUENSCHWANDER, EXECUTIVE VICE PRESIDENT, PITTSBURGH & LAKE ERIE RAILROAD CO.

My name is Gordon E. Neuenschwander. I am the Executive Vice President of the Pittsburgh and Lake Erie Railroad Company ("P&LE"). The P&LE operates over approximately 500 miles of track, running from Brownsville and Connellsville in southwestern Pennsylvania, through Pittsburgh where we are headquartered, to Youngstown, Ohio and to Shenango, Pennsylvania, Ashtabula, Ohio and Buffalo, New York on trackage rights. The P&LE and its affiliated railroads could be seriously and adversely affected by the combination of Conrail and Norfolk Southern ("NS").

The P&LE was built over a hundred years ago by Pittsburgh business interests to connect the Pittsburgh area with the New York Central Railroad, thereby breaking the competitive stranglehold which the Pennsylvania Railroad held over the Pittsburgh area. Throughout its first hundred years, during which it was a corporate subsidiary of the New York Central System, the P&LE operated profitably and thrived upon the movement of large volumes of iron ore, coal, iron and steel, and other industrial products. The New York Central and Pennsylvania railroads merged in 1968. After the bankruptcy of the Penn Central in 1970, the railroad properties were taken by the Government in 1976 to form Conrail. The P&LE was not included in this transfer. Instead, it was retained by the Penn Central which later sold it in 1979 to private owners.

As originally envisioned by the U.S. Railway Association (USRA) Conrail was to have been considerably smaller than it was actually configured in 1976, with other eastern railroads purchasing certain of what became Conrail properties. The competitive environment envisioned by USRA was not to be, however, and USRA, in its Final System Plan, recognized that a huge Conrail would require enhanced regulation by the Government to temper and control its monopolistic power.

That was the situation nine years ago. Since 1976, rather than more regulation, as envisioned by USRA, Congress and the ICC have significantly deregulated the railroad industry and Conrail has adroitly exploited its newfound power with a vengeance. It has canceled joint rates and routes. It has set rates and switching fees in such a way as to exclude competition. It has interfered with service where, in so doing, its only purpose can be to hinder competition. These anticompetitive activities have been especially devastating to the P&LE since Conrail is comprised, in large part, by the P&LE's old parent and principal friendly connection, the New York Central.

The P&LE operates the largest number of rail freight cars among the nation's regional rail carriers. Even among all of the nation's rail carriers, this fleet ranks seventh in size. Much of the fleet is new, having been acquired in 1980 and 1981 as part of a program designed to provide better and more efficient service to shippers.

In spite of the economic hardship caused by the downturn in heavy industry in the Pittsburgh-Youngstown area and the impact of Conrail's unfair competitive practices, the P&LE has survived. In recent years, the volume of P&LE business has dropped from 300,000 carloads or 19 million tons annually to half that amount. Its survival under these conditions is known in the industry to be the result of vigorous cost cutting, effective management and loyal support of shippers and creditors.

Since Conrail's formation, the P&LE has sought and fought to maintain its traditional role as a competitor in the Pittsburgh-Youngstown area—earlier as the principal competitor to the Pennsylvania Railroad and more recently as the principal competitor to Conrail. Since Conrail's formation, the P&LE has relied substantially on Norfolk Southern as a friendly east-west connection, replacing the old New York Central. In 1983, for example, 27% of P&LE's interline revenue was derived from joint hauls with Norfolk Southern in movements which were competitive to Conrail single line hauls. This revenue, the competition which it represents, and the future of the P&LE and its customers are placed at risk by the combination of Norfolk Southern and Conrail.

Were that combination allowed to proceed without remedies designed to preserve meaningful competition, the P&LE would have no choice but to oppose it vigorously. However, the Department of Justice, by its letter of January 29, has required certain divestitures and adherence by Norfolk Southern to certain conditions which Justice believes will preserve some of the competition which would otherwise be lost. We have carefully studied the Justice Department letter. While its conditions will neither create the level of competition originally envisioned by USRA, nor preserve competition in every market affected by the combination of Norfolk Southern and Conrail, they are an important step in the right direction.

We have been gratified by the actions of the Secretary of Transportation in recognizing the need for and role of the regional railroads, including the P&LE, and their essential value in ensuring continued rail competition within the Conrail region. We are confident that the Secretary's selection of the Norfolk Southern to purchase Conrail fully recognizes the inherent weakness of public sale as an effective alternative in the return of Conrail to the private sector.

Representatives of Norfolk Southern have stated that they will embrace the conditions of the Justice Department's letter. For our part, we have been in negotiations with Norfolk Southern, and together we have agreed, in principle, that the P&LE will acquire certain lines and receive trackage rights over other lines. These acquisitions will allow the P&LE to reach Toledo, Ohio where it can connect with the Grand Trunk Western Railroad, and to serve the east via Connellsville, Pennsylvania as well as Cleveland, Ohio on the north. Of course service will also be provided to numerous communities and important shipping areas between these points.

We cannot appear before you today and say that the properties to be divested by Norfolk Southern and acquired by the P&LE, and the trackage rights which we are to receive, are a perfect solution. However, we support the proposed combination, if the conditions upon which it is based, including the conditions set forth in Justice's January 29 letter as they relate to the P&LE, are fulfilled. We are comfortable in this position because we believe the divestitures and other conditions required by the Department of Justice and embraced by Norfolk Southern will do much to remove the abuses perpetrated by Conrail and restore a measure of true competition to the market.

I thank you for this opportunity to appear before you today to address this most important issue.

The CHAIRMAN. Thank you, Mr. Neuenschwander.

Mr. Mellon.

Mr. MELLON. Mr. Chairman, members of the committee, I would like to read my entire summary, if possible.

Since 1981—and by the way, I am chairman of Guilford Transportation Industries, which is a holding company for three New England northeastern railroads.

Since 1981, we have assembled a strong competitive regional rail system in the Northeastern part of this country. It is important to point out that the Guilford system would not exist today without active support and legislative efforts taken by this committee and your companion committee in the House.

Over the years, you have assisted in authorizing low-interest preference share financing which was used to restore the main line of the Boston & Maine Railroad during its years of bankruptcy prior to our ownership. You helped continue the operations of the Delaware & Hudson Railroad during the years when it was felt the D&H couldn't possibly survive, and you have assisted in making essential statutory changes which permitted Guilford to acquire the D&H just over a year ago.

Your commitment to a sound rail system in our region of the country is appreciated not only by us, but by all the shippers who are now benefiting from this new competitive railroad system.

It is with this background in mind that we are optimistic that the committee will also play a significant role in the transfer of Conrail back to the private sector.

Before I talk specifically about the transfer proposal, I believe it would be helpful to explain a little about Guilford's involvement in this entire transfer process. In January of 1984 when we acquired the Delaware & Hudson and finished creating our northeastern system, we felt that we faced a period of stability and were looking forward to molding three separate carriers into a single team.

We were aware that we faced some of the strongest competitive circumstances that any railroad in our area has faced in many years. To the North and in every New England State where we operate, we compete with the railroads which make up the Canadian Government Railway System, the Canadian National, and the Grand Trunk Railway.

To our south, we compete with Conrail across our entire railroad. In addition, we compete in many areas with the Canadian Pacific Railway. By coordinating the efforts of our three carriers and through scrupulous attention to our costs, we are very competitive in a deregulated environment.

I am pleased to tell you today that the Maine Central continues to be a strong profitable railroad. The Boston Maine has seen its best year in certainly over 20 years and is today a sound and profitable railroad. We are pleased with the system as it is today, and are confident that our first full year of operation provides us with a strong base for the future.

After we acquired the Delaware & Hudson, we expected some stability in our region. That assumption was changed when we heard the announcement that Norfolk Southern intended to submit a bid for the acquisition of Conrail. Since one of the main purposes of acquiring the Delaware & Hudson was for us to reach the Norfolk Southern in Buffalo, we were obviously deeply concerned how their bid could affect our future.

It appeared clear that a sale of Conrail to Norfolk Southern would, at a minimum, require the cessation of service by the Delaware & Hudson and the loss of over 1,300 jobs in Pennsylvania and New York State. While the D&H provided the Guilford system a vital link to markets and shippers in the Midwest through our connection with the Norfolk Southern, we realized that a sale of Conrail to Norfolk Southern would deprive us of access to those markets and to the competitive traffic that Norfolk Southern offered us at Buffalo.

That caused us to seriously evaluate the measures that might be necessary for us to counter such a bid. One option we looked at was the submission of a bid ourselves to acquire Conrail. We decided to go ahead with that bid and formally submitted our offer to the U.S. Department of Transportation last June.

As the review process by the Department continued throughout the summer, it became evident that the list would be reduced by—and by September, the final bidders on the Department's list were the Norfolk Southern, Alleghany, and the Marriott group.

Once the list was reduced to three, we felt it essential to again evaluate each of the bidders to determine which would meet the same criteria that we used in originally submitting our own bid for the entire system. We realized that our region of the country could not once again suffer the type of decline our railroad suffered back in the 1960's and early 1970's, and we also realized that for the Guilford system to flourish, it was essential to have the Conrail system which would remain strong and competitive.

While we compete vigorously with Conrail in many areas, we also interchange a substantial amount of traffic with Conrail. For us to remain competitive, it's also essential that Conrail remain strong.

For that reason, we felt that a prospective buyer should meet several criteria. First, the buyer not only had to be committed to the successful operation of the railroad, but had to, in our minds, have clearly demonstrated that commitment.

Second, the buyer had to have the managerial ability and talent to continue the progress that Conrail has demonstrated in the past 3 years.

Third, the buyer clearly had to have the financial resources to guarantee the maintenance of Conrail's physical plant and to ensure operations in times of financial growth as well as during times of recession.

Fourth, the prospective buyer had to have the ability to finance the acquisition in a prudent manner which was satisfactory to the Government.

In looking at the three prospective buyers that the Department was evaluating, it was clear to us that the one that stood out above all others was Norfolk Southern. The determination that Norfolk Southern was the best buyer for Conrail may sound somewhat contradictory to my earlier statement that acquisition by Norfolk Southern could also seriously impact the financial health of a large segment of the Guilford system.

I believe our support must be taken in context with our prior dealings with Norfolk Southern. You may be aware that the Delaware & Hudson was acquired by Guilford from Norfolk Southern. In all of our negotiations on the D&H, we were impressed by the integrity of the entire Norfolk Southern team. We developed a trust for their word and an understanding that they would live up to their commitments. And while we had secured no concessions from Norfolk Southern to protect Guilford traffic or any of the other measures that are traditionally imposed on mergers of this size, we felt confident that at the appropriate time and under the appropriate controls, we would be able to sit down and work out our differences.

That process of working out our differences developed in the context of a review of the Norfolk Southern acquisition by the U.S. Department of Justice. Prior to the release of the Justice findings on this acquisition, we were requested by the Federal Railroad Administration to join with them in a meeting in Washington to explore our interests with Norfolk Southern in the acquisition of certain lines which would permit a competitive carrier to serve specific markets that the Department of Justice found would be lacking in competition if Norfolk Southern were to acquire Conrail.

It was our understanding that FRA had met with other carriers regarding the proposed divestiture.

Following an initial meeting at the Transportation Department, Guilford began in early January a series of meetings with Norfolk Southern which were at all times supervised by a representative from the U.S. Department of Transportation under guidelines set up by the Justice Department.

Once the line segments the Guilford was interested were identified, they were cross-checked by us and Norfolk Southern against the letter sent by the Justice Department to Secretary Dole to ensure that the competitive issues were met and that the proposed system will satisfactorily meet the criteria set by the Department of Justice.

Mr. Chairman, if I may, I'd like to describe that system on the map we have here, and a copy of this map was provided in the testimony.

In the East and in the darker lines, starting at the furthest East, the eastern-most extension, the Maine Central comes down to Portland, whereupon the Boston & Maine carries along over to Albany, from Montreal down to Binghamton and Scranton with further trackage rights to Washington Potomac Yard in Virginia is our existing system, including the trackage rights over Conrail to Buffalo.

What we have proposed and what we have a tentative agreement with Norfolk Southern to buy from their combined acquisition if they are successful, is their track from Buffalo to Cleveland, continuing on trackage rights over a Conrail line to Crestline, Ohio; thence, over the old Pennsylvania line from Crestline to Chicago, with another branch from Delphos in Ohio to St. Louis; branches to Indianapolis and a branch to Toledo.

These address the markets that were identified by the Department of Justice as being lacking in the appropriate amount of competition according to their criteria, those being Buffalo, Cleveland, and Lorain, OH; Toledo, Fort. Wayne, IN; and Indianapolis.

A further part of their criteria was the necessity of having competitive rail service in a corridor between the cities of Buffalo, Pittsburgh, Chicago, and St. Louis on the West.

Our proposed system, together with that of the Pittsburgh & Lake Erie, just described, will provide that competitive service. We feel that it is essential for the railroads in the Northeast, which had relied on this connection with Norfolk Southern prior to this proposed acquisition, be allowed to continue and interchange with other railroads. Otherwise, these railroads will be totally subject to the Conrail/Norfolk Southern combination.

We feel that this will be a competitive system. The competition comes not only from the Conrail/Norfolk Southern system proposed and from the CSX system which is in the western part of this area, but also from the Canadian Railway System which runs all the way from the Atlantic clear across to the Pacific Ocean and down into the Midwest in the form of the Grand Trunk Railway.

The Canadian Grand Trunk is as much a competitor of ours as is Conrail. We feel their competition every day, and they are very good at competing with us. We want a way to compete over the long term.

And if you have any questions, I would be happy to answer them.

The CHAIRMAN. Mr. Mellon, thank you very much.

Thank you to the panel.

Mr. Watkins, you argued very effectively today for a position which to me seems quite contradictory to the general way of operating that CSX and its predecessors have had over their history, and also inconsistent with positions CSX has taken with respect to this particular transaction.

With respect to your own history, your company has been built by mergers since 1963, and you have argued in favor of mergers. At the time of the Chessie Seaboard merger in 1980, CSX appeared before the Interstate Commerce Commission and took the position that efficiencies and improved services of a single system would inure to the public interest and would enable CSX to compete for additional traffic.

Then at the time of the acquisition of American Commercial Lines, which I might say sent chills through an already quite ill inland waterway system, CSX was able to just dismiss any claim of diversion. In the ICC proceeding CSX said in arguing against diversion analysis:

> As a result of the increased efficiency and more competitive service, other rail and water carriers will be spurred to become more efficient in general, to the benefit of the shipping public.

It would appear to me, and maybe this is unfair to CSX, that when CSX is involved in acquiring somebody or merging with somebody, why that spurs everybody else to be more competitive. But when somebody else is involved in a merger, oh, that's just terrible and you are ready to not only not be spurred, but to throw in the towel with the B&O.

Mr. WATKINS. Senator, rather than having a disagreement with you, let me say that your comments, I think, completely substantiate our position. There is no question that mergers improve efficiency and to that extent benefit the customers. Both the C&O, B&O, later the Chessie Seaboard mergers, and now the ACL/CSX merger were all designed to promote efficiency.

By the same token, a combination of Conrail and Norfolk Southern will presumably increase the efficiency of that combined company. There is no question that it will. My concern, Senator, is the fact that in the past, mergers have been fought out in public hearings with all aspects questioned and reviewed and the interested parties having the opportunity to present their cases and have their concerns agreed or disagreed with, and claims, and counterclaims aired.

In this particular case here, though, we have something unique. We have a proposed parallel merger where one company would have more than half of the volume and something over two-thirds of the gross revenue of an entire area of the United States being put together. Our position is that the sheer economic weight of that parallel combination, while it certainly would improve efficiency, would effectively kill meaningful competition.

So, rather than having a disagreement or a difference with our position in the past, I think this overview is clearly consistent. The only way mergers can improve efficiencies are either by attracting additional business or by reducing costs, namely, people.

We have heard testimony the last 1½ days that the impact on reduction of employment of a Conrail and Norfolk Southern merger would be very nominal. We have also heard testimony, erroneously I might say, that there would be little or no diversion from CSX. You can't have it both ways. A merger must have increased revenue or reduced employment.

In our case we are convinced, based on our experience in our mergers, that single system service does indeed attract diversions. We had that in our Chessie Seaboard end-to-end merger, the CSX case. We have diverted traffic because customers like to deal with one company, but substantial competition remained. That is the precise point that concerns us.

I do not expect you in the committee to be concerned about our private fortunes. We had discussions this morning about the stockholders, the employees, and——

The CHAIRMAN. Let me ask you about a general principle. I don't want to cut you off, but I also don't want to go on too much into the evening here. Your testimony today is that—and I am quoting from your prepared statement:

> The Allegheny and the Marriott proposals would each have been acceptable to us, even if not in our view the best solutions. And the public offering of the Government's ownership of Conrail stock remains a fair, equitable, and practical alternative.

Now, you say that you were not consulted by Secretary Dole, but you certainly were involved in a letter-writing effort.

Mr. WATKINS. That is right.

The CHAIRMAN. I am going to read you parts of your letters, just excerpts; first, from a letter of November 16, 1984, and second from a letter of June 13, 1984, you writing in each case to Secretary Dole.

Mr. WATKINS. Those were my two letters to the Secretary.

The CHAIRMAN. It seems to me that in these two letters, you take the exact opposite position you take today. You say that you don't want Alleghany or Marriott to acquire Conrail and you don't want a public offering either. I'd like to just quote from your letters:

> Financial integrity contributes to the long-term preservation of a central rail service, cushions the corporation against the cyclical downturns which typify the rail industry, reduces the risk of a return to the Government, and permits the establishment of a normalized labor management structure based on consensus rather than panic. Thus, financial integrity can best be assured by assimilating Conrail into the railroad industry. The sale of Conrail to a non-railroad entity fails to shore up Conrail's inherent vulnerability. A sale to the Alleghany or Marriott interests represents, after all, a difference only of degree and not of kind from the public offering route. Conrail would remain a regional carrier without committed reserves to abide the cyclical adversity which has beset every railroad that has ever operated in its territory.

And then on June 13 you wrote:

> In summary, rail traffic in the Conrail service area will not grow and is likely to continue its decline over any foreseeable period. The business cycle will produce a recession at some point, and the market will only support two carriers. Because of Conrail's particular vulnerability to truck diversion, its lack of significant coal reserves, and the lack of a strong parent, an independent Conrail will be the carrier to fail, causing turmoil in its region and adversely affecting carriers such as CSX who shares so much traffic with Conrail.

Now, it just seems to me that your testimony today really is contrary to the history of CSX which has been built by mergers, contrary to the arguments that you make when you want to involve yourselves in mergers, and contrary to the positions that you took when you wrote twice in 1984 to Secretary Dole with respect to the future of Conrail, and with respect to your opposition to either a public offering or the sale to somebody other than a railroad.

Mr. WATKINS. As I indicated, Senator, early in my testimony, we still feel that the creation of two balanced systems in the East through a section 401 procedure was, and is, the right alternative.

This has not been adopted either by Mrs. Dole or by the public or by this body generally. Therefore, recognizing the old adage that the best should not be the enemy of the good, we have faced reality. And so what we have now are really two alternatives, either a combination of two of the three major systems in the East into one, or another alternative, the only other alternative which has come along, the public offering.

Again, I don't feel that our position is inconsistent. I feel it does recognize reality, and I have the responsibility to point out to you, again not for sympathy—let me assure you of that—but from economic reality, that the proposal before us here will create such economic harm to CSX that we will have no choice except to withdraw from the Northeast

Now, I don't feel that is the least bit inconsistent. I think that is recognizing economic reality. And if we do withdraw from the Northeast, and as I said we are prepared to do so, then the competition that remains, with all due regards to my two rail associates on my right, I don't feel will be meaningful competition.

So, no, I really don't feel that our position is inconsistent. In fact, the benefits and the economic power of mergers, particularly a merger of Norfolk and Conrail, would be of such import that we have no choice except to protect our stockholders' investment by recognizing reality. That is the only thing.

Painful as it is, competition is still the best thing we have. And competition can better be created by three systems in the East than by creating one gigantic system which leaves the rest of us trying to catch up.

The CHAIRMAN. Well, you have managed to stake out every position possible in order, and then to oppose every position possible in order. You would be a brilliant lawyer.

Mr. WATKINS. Coming from the bean counter side, Senator, that is a compliment. Thank you.

I regret creating a bad impression. Our position from the first, both publicly and with Mrs. Dole and the Department, was that a balanced system through a 401 arrangement was the best. The other alternatives we felt had drawbacks, and my letters from which you quoted certainly indicated that.

We still feel that way. We also are realists. We recognize if we have two alternatives we should express our position on those alternatives which are practical, and this is what we have done.

The CHAIRMAN. Senator Trible.

Senator TRIBLE. Well, first let me, after that round, warmly welcome my friend Hays Watkins. I must say that I would much prefer to see you in church in Kilmarnock, VA——

Mr. WATKINS. That may be where I am after this is over.

Senator TRIBLE [continuing]. Than in these rather contentious surroundings. But as always, you acquit yourself brilliantly.

Let me just tackle a couple points. Perhaps the size of CSX and the position of CSX in the marketplace limited the options available to your corporation. But it does seem that you are in a difficult position and perhaps have been overtaken by events.

And let me address, if I might, two salient points that I think have been identified. Hays, the centerpiece of your concern, as I understand it, is that the sale of Conrail to Norfolk Southern would destroy competition effectively in the Northeast. And you have stated your case in some detail in your statement, which I have read.

On the other hand, the Justice Department and the Department of Transportation, the so-called experts in the field of antitrust law, have taken a look at the situation and they have said that, given certain modifications, this merger is acceptable. How do we reconcile those two positions?

Also, I would add, we heard today from two regional railroads who have said that, given the modifications that would be implemented and that have been agreed to at least preliminarily, that they would be in a position to be more competitive than they are today. Help me with that.

Mr. WATKINS. Let me comment first on the Justice Department position. Last year CSX made extensive studies to see whether we should make a bid for Conrail. Our concern for profits and the benefit of our shareholders is equally as strong as Conrail's and Norfolk Southern's and all of the others.

We had an extensive internal study. Our lawyers, particularly our antitrust lawyers and economic consultants, said there is no way that the anticompetitive effects of a CSX-Conrail combination could be successfully achieved.

Not believing that, we then went to an outside group, specifically Arnold & Porter in Washington, and asked them the same question: If we make a bid for Conrail, what chances do we have that this might be successful? We have a detailed writeup which you and the other members of the committee who are lawyers would understand, which says loud and clear our chances are small to none.

Not being satisfied there, our people met directly with the Antitrust Division of the Justice Department. We were led to believe in clear terms that the Antitrust Division would resist any combination of Conrail and CSX and, by the same token, any combination of Conrail and Norfolk Southern.

So based on our internal studies, our outside experts, and our discussions with the Justice Department, we decided that the efforts perhaps would probably not be worth it, and so we did not make a bid.

Now, you will ask what happened between then and now that the Justice Department reversed its position. I would have to say, Senator, I wish I did know the inside story. It would probably be interesting. But I am convinced of one thing: that the antitrust merger guidelines that we have lived under in the creation of CSX and of Norfolk Southern, the ones to which the chairman referred earlier, the guidelines that we have been living under for the past 30 years, certainly have been completely discarded in this Justice Department report.

So what happened? I do not know. I am not a lawyer. Maybe I should be.

As far as the other one, the meaningful competition, again with due regard to my friends on my right—and we compete for traffic with them as well as we do with Norfolk Southern and Conrail—I have to say that meaningful competition by two railroads whose mileage is extended but whose customers are not necessarily increased is not my idea of meaningful competition, particularly when the merger that fosters these two regional carriers is also aimed directly at killing the one effective competitor which Norfolk and Conrail now have in the Northeast; namely, CSX.

I wish I knew what happened in the change of the Justice Department.

Mr. **Walker**. Senator, I would like to comment on that as a regional carrier, because we also did a study and in fact we were extremely concerned, as I mentioned earlier, regarding the market power of NS-Conrail combined as it affects the regional carriers.

And we truly are a small regional carrier, and we do compete with N&W, Chessie, and Conrail today. And simply by drawing lines and getting to gateways on a map does not make you a competitor. To compete you need to have better service or at least as good service.

To compete you need to have better transit times or at least as good transit times. To compete you need to have adequate carload volume, that is density on that line. And to compete you need to have a structure that generates a profit so you can pour some money back into the plant and pay off your stockholders with a reasonable dividend.

All of those features are necessary to provide a competitive system. Now, the DOJ has suggested that they are going to review this particular system or any divestiture plan prior to signing off on this. It is Grand Trunk's position quite clearly that, based on our experience in trying to compete with large rail systems—and by the way, I feel that we do a rather effective job of competing with them.

But at the same time, it is a very difficult row to hoe, and there is no way that this particular divestiture plan will ever provide adequate competition from the standpoint of the Justice Department's criteria, and that is why I was suggesting that somehow or other there has to be a source of an objective viewpoint and review of what kind of a divestiture system, system of divested lines, will provide the necessary competition that I think everyone agrees is absolutely necessary.

There has to be some kind of a divestiture, and to simply walk up to this and say, this is the one that meets the needs, it doesn't meet the needs. It is the line suggested by NS that meets DOJ's criteria and recommendations, and I am sure they do not want a strong competitor.

Mr. **Mellon**. Senator, can I make a comment along those lines?

Senator **Trible**. With the chairman's indulgence, my time has expired, but I think you can.

Mr. **Mellon**. Yes, sir. I have personally reviewed, I have flown over all of the lines that you saw on that map. They are all in very good condition. I feel that they would support any amount of traffic that we could ever find to take to St. Louis and to Chicago. They were designed originally as high density lines and they are all in good condition.

The other point I would like to make with reference to Mr. Watkins' comments is that if the Baltimore & Ohio Railway is ever up for sale, we would be interested in buying it. We feel we could compete in that area.

Mr. **Watkins**. Mr. Chairman, yesterday——

The **Chairman**. I was going to ask you, Mr. Watkins. It is not my time, but I was going to ask you how much you want for the B&O.

Mr. **Watkins**. As a matter of fact yesterday, for the first time, I heard that there were at least four bidders interested in the B&O, and I intend to ask the Secretary who those four are. Believe me, if this thing goes through I will be negotiating with all four of them.

Mr. **Mellon**. Maybe it should be a public offering.

The **Chairman**. Senator Hollings.

Senator **Hollings**. Mr. Watkins, I am looking with interest at this letter, because it really reaffirms my memory of our conversation when you and I discussed this some time ago. And incidentally, I look to do Seaboard a favor, not Southern.

Twenty five years ago when I was trying to bring Eastman Kodak to South Carolina, Luther Hodges of North Carolina had the Southern Railroad, with the big reception car and the bar and the big meal and everything else. They took Eastman Kodak people all around Fayetteville and practically announced the site.

And I contacted Southern Railroad and they told me to go ahead and find my own railroad, even though I had a site on their line. And the Eastman people were really looking for competition. So we have been in this competition amongst railroads for some years now. And they said they possibly could come if I had Seaboard or another line serve it, and Warren White of Seaboard brought the line down, and I got the $600 million plant away from Luther Hodges into South Carolina.

And so I, you know, want to help. But I am looking and I am remembering exactly what you said. You said that just Conrail by itself could not exist. And referring back to this letter, which is better than my citing my memory, you say:

> Neither law nor management can alter the dynamics of the Northeast economy or arrest the erosion of Conrail's market.

And then, talking about that business cycle, you say:

> Because of Conrail's particular vulnerability to truck diversion, its lack of significant coal reserves and lack of a strong parent, an independent Conrail will be the carrier to fail.

And now we are testifying for an independent Conrail. You wanted it to go into a railroad. You said: "Thus, financial integrity can best be assured by assimilating Conrail into the railroad industry." Now, that is what we have had proposed to us.

And since time is so limited, you do not get many questions. But I will go to your statement. And maybe, since you have taken all other positions, you will finally favor Norfolk Southern. Here is what you say. You say here, and I quote, most respectfully, Mr. Watkins:

"We are exploring ways in which CSX could financially participate in such an offering." A public offering, you are referring to. "We are also exploring ways to enter into mutual arrangements with Conrail that would strengthen both systems and provide for increased competition."

Now, is that not exactly what Norfolk Southern is doing?

Mr. **Watkins**. Yes, sir.

Senator HOLLINGS. They are entering into a mutual arrangement with their bid for Conrail to strengthen both systems and provide for increased competition.

Mr. WATKINS. Yes, sir, that is exactly what we would. That is our position. Let me remind you, though, Senator——

Senator HOLLINGS. Well, why do you not do it—give a better price? Go from $1.2 billion to $1.3 billion? You heard your friend——

Mr. WATKINS. The problem, Senator, is very simple, and that is the public policy question as to whether effective competition is to be retained in the Northeast. That is the bottom line.

Our position is that effective competition, which I still completely favor and am for, despite the chairman of the Norfolk Southern's statement otherwise, our position is that competition is the name of the game. In your own State of South Carolina, Seaboard, as a part of CSX, and Southern, as a part of Norfolk Southern, are very active competitors.

The concern here is that the creation of a combined Norfolk Southern-Conrail will effectively eliminate competition. And I submit to you, sir, the question is whether effective competition in the Northeast as a matter of public policy should be the paramount issue.

Our position is that that competition should be the paramount issue. I am not afraid of competition, but when two-thirds of all of the traffic is to be combined in one colossus, we must recognize economic reality. We have two choices. Either to completely withdraw as an effective competitor, which will be forced on us, or take a less undesirable alternative and that is to continue with three competitors.

Now, I still submit that over the long pull the problem of the Northeast is as severe and the prospects as dim as I have indicated. The question, though, is whether we have three effective competitors now or whether we eliminate effective competition immediately. That, sir, I submit is the key question.

Senator HOLLINGS. You said three effective competitors?

Mr. WATKINS. Yes, sir.

Senator HOLLINGS. In my conversation with you, you said that Conrail could not survive up in the Northeast. You were telling me that three big railroads could not survive in the East and that Conrail could not survive as a single entity, and that we needed to move to two. Is that not the case?

Mr. WATKINS. That is right.

Senator HOLLINGS. And your proposal was to split it up.

Mr. WATKINS. That is right, to preserve competition.

Senator HOLLINGS. Instead of splitting it up, DOT tried to—well, now the proposal is—we can look at it and see whether the word "colossus" is an appropriate description.

They say that the conbined system will have more line, but not more revenue. You dispute that.

Mr. WATKINS. If you add up the profits in 1984 of the three systems, in the Northeast, 85 percent is Conrail-Norfolk Southern, 15 percent is Chessie. I would submit, sir, that is not equal competition. And anyone that risks shareowner money for that 15 percent is creating a great risk, and I would not feel justified in doing it.

Senator HOLLINGS. Well, I understand what you are saying now, but that is the way we started off. I listened closely and then began to look into this as a result of your visit. And I did not know about these letters having been mailed to that effect. It just seems that you are doing a good job to protect your competitive position.

Mr. WATKINS. We are trying to remain competitive, yes, sir, no question.

Senator HOLLINGS. And I do not blame you for that. But we will have to look at it closely and look at those revenues. And the Justice Department has looked at what you have said would be a colossus and destructive of competition, and they have found that, with certain things being done, on the contrary it would promote competition, and some of the carriers are here testifying at the same table, at the same time, that it would.

Mr. WATKINS. I guess, sir, that we come down to the fact that, as the steward of our shareowner's money I am unwilling to risk the CSX stockholders' money in such an unequal competitive arena in the future. That is really what we come to.

That is why I say the issue here is one of preserving competition. I do not say that in anger or as a threat, and I regret that my emotional tone occasionally may convey that. All I recognize is that the economic power of this combination will overpower us. The sooner we recognize that, the better our shareowners will be, and the quicker, frankly, I intend to act.

Senator HOLLINGS. Well, I appreciate that. But of course, you have said that the purchase by Alleghany courts financial disaster for Conrail and that there is no difference between Alleghany and Marriott; a sale to either one represents a difference only of degree and not of kind from the public offering route.

So that was a disaster. And now we find that that is what we are exploring. Well, you are strong in your opinion, whatever it is.

Mr. WATKINS. Perhaps I should have hedged my statements. Perhaps I should have hedged my statements to Mrs. Dole. Maybe people do not agree, but there is never any doubt as to our position. I feel our position is consistent.

We have said what we thought was the best. But if that is not feasible, let us take the alternatives and review them.

The CHAIRMAN. Let us say there is no doubt as to your position of the moment.

Senator HOLLINGS. That reminds me of the way they describe me at home: Seldom right, but never in doubt.

The CHAIRMAN. Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Mr. Watkins, it has come to my attention—and I apologize for being late, Mr. Chairman, for this hearing this afternoon. There were some reasons for that, and I was doing some checking back home.

But it has come to my attention, and I understand that it might have come out in testimony this afternoon—and you will forgive me therefore for going over what may be repetitious material—that when you had originally looked at the possibility of entering into the bidding, one of the reasons, indeed a rather strong reason, that you did not was because you were told at least at some level of the Antitrust Division of the Justice Department that it would not be permissible either for CSX or for Norfolk Southern to compete for this type of prize, so to speak, and that it would not be acceptable. Therefore that was at least in part the reason for your not pursuing the issue.

Am I correct?

Mr. WATKINS. That was the largest reason for our not pursuing it, because this came on top of our own internal discussions and a further discussion with outside antitrust experts, namely Arnold & Porter here. So the three results all coinciding led us to believe this would be a futile exercise. And that, yes, is one of the primary reasons why we felt it would be a futile gesture to bid.

Senator ROCKEFELLER. Was this transmitted to you verbally or in written form, and from people in what you would say major positions in the Antitrust Division or by people whose views could be, let us say, reversed at a higher level?

Mr. WATKINS. As far as Justice, the specific discussion was between the chief legal officer of CSX, John Snow, executive vice president, and I believe Mr. Elliot Siden, who is head of the Transportation Division in the Antitrust Division. And this was Mr. Snow's clear and unmistakable and unquestioned opinion of the result of that discussion.

Senator ROCKEFELLER. As far as you know, the Norfolk Southern folks were never given that same indication by the Antitrust Division people?

Mr. WATKINS. I have no idea. Since the advent of the Staggers Act, I very rarely discuss any matters with other railroad officers.

Senator ROCKEFELLER. Do you have any idea as to why a decision of that sort, at that level, at that time, was presented to you and not to Norfolk Southern?

Mr. WATKINS. I have no idea whether it was presented to Norfolk Southern, what their studies were, what their questions were. I have no idea whatever.

Senator ROCKEFELLER. And at what time was this pronouncement, which obviously affected your decision as the largest of the railroads in the Eastern part of the United States, transmitted to you?

Mr. WATKINS. Our staff study started at the end of 1983 and continued up to the time of the date of the bidding, which I believe was June 13, 1984. So our discussions, our internal memorandum, our outside counsel, and then the discussions with the Antitrust Division, would have been in the first 5 months. And I would assume that the meeting between Dr. Snow, and Mr. Siden, and the associates would have been in May 1984.

Senator ROCKEFELLER. In May 1984?

Mr. WATKINS. Before June 13, which was the critical date.

Senator ROCKEFELLER. Which would have left approximately 1 month or so for whatever happened to happen?

Mr. WATKINS. That is right.

Senator ROCKEFELLER. I suppose it is possible, Mr. Chairman, for decisions to be made at one level of Government and for those decisions then to be reversed on some substantial basis at another level of Government within the same Department.

On the other hand, I have to say that when I learned of this and that it had arisen, at least in some form, also this afternoon, it struck me as most odd. I do not understand why it would be possible for the U.S. Government to be saying to the largest railroad in the Eastern part of the United States that there is no way that you can get into this process because it would be of an antitrust nature, a monopolistic nature, or whatever—and my great-grandfather, they tell me, was pretty good at that and not transmitting the same decision to the other major competing railroad. And from my point of view, I do not think a hearing is necessary, but Mr. Chairman, I would be very interested to hear what happened from Mr. Seiden or from those individuals involved with that decision in that relatively short period of time.

I want to know what happened. I want to know why it was that CSX was told no, you cannot, some time in April or May, and then on June 13, or June 18, or whatever the appropriate day was, Norfolk Southern was told that was all right.

I find that strange, I find that bewildering, and I find that worthy of an answer, Mr. Chairman, to this committee, and I would press for that.

If I could ask one more question?

Mr. WATKINS. If I might just comment, Senator. To the extent that we can furnish any data as to written reports, and also furnish Dr. Snow who conducted the discussions as a witness, we are fully available and prepared to offer Dr. Snow and whatever memoranda we have to this committee.

Let me say, though, I do not know that the Justice Department reversed its position between the time of our discussions and June 13. It reversed its position or was overruled or otherwise changed its position between May and January of this year. So what the specific timing and discussions during the summer were between DOJ and the Department of Transportation I am not privy to.

Senator ROCKEFELLER. And it could be that it was at a later time, if there was a reversal.

Mr. WATKINS. It could well have been.

Senator ROCKEFELLER. But I am not sure that that makes a great point.

Mr. WATKINS. Only a matter of time. The results, the reversal are there.

Senator ROCKEFELLER. That is correct. Had this decision not been transmitted to your Mr. Snow, would it have been possible that CSX would have gotten into this in a more substantial way?

Mr. WATKINS. I think it is likely that if we had been advised by internal counsel and by outside experts and by the Justice Department that we at least had a 50/50 chance, I can assure you we would have had a dollar bid on June 13. There is no question.

Senator ROCKEFELLER. You are certainly not without the resources to put that together.

Mr. WATKINS. We were not without the resources. We were not without the inclination. We recognize, though, that the antitrust provisions taken together with the history over 30 years of working in mergers, the last one of which was the ACL–CSX merger, and reviewing Justice Department guidelines, that all of these things laid a consistent fabric of opposition because of antitrust considerations to a combination of two of the three large units in the East. So the answers we got were completely consistent with what we expected, what one would normally expect and, frankly, what one today would normally expect.

But with that consistent fabric we recognized reality and, again, we talk about reality. We recognized reality, that it would have been a completely futile gesture, and we had a few other things to worry about.

Senator ROCKEFELLER. My time has run out. Thank you, Mr. Chairman.

The CHAIRMAN. Did you consult your own antitrust lawyers with respect to this?

Mr. WATKINS. Yes; our first study in the early part of the year was with our in-house counsel and our antitrust lawyers. After getting the answer from them and being a person who does not take no for an answer, we then said OK, let us go to the outside experts. We went, as I say, to the firm of Arnold & Porter.

The CHAIRMAN. OK. And what did your own lawyers and then Arnold & Porter say?

Mr. WATKINS. Both of these groups—in-house and our outside experts said that the existing merger guidelines, the antitrust regulations are such that we would have a very slim to no chance. The same answer came three times from three different groups. That is why when I get beat on the head three times, I finally say OK, lawyers, I may not agree with you, and I do not like it, but I recognize reality.

The CHAIRMAN. So, as I understand, your position is that from a business standpoint, you would have liked to put in your own bid?

Mr. WATKINS. We would have put in our own bid.

The CHAIRMAN. You would have put in your own bid, and you would have liked to have acquired Conrail, but you were advised by your own lawyers that you could not. Was that in-house?

Mr. WATKINS. In-house first, and then our outside counsel.

The CHAIRMAN. Arnold & Porter.

Mr. WATKINS. And then the discussions that Dr. Snow had with Mr. Siden.

The CHAIRMAN. Were those confirmed in writing by the Justice Department?

Mr. WATKINS. I would have to defer to Mr. Snow. I believe it was discussion, not a memorandum. I can ask John, was there anything in writing?

Mr. SNOW. A memorandum I made of the meeting.

Mr. WATKINS. A memorandum Mr. Snow made of the meeting, which again it would be our version of it.

The CHAIRMAN. Not a written opinion of the Justice Department?

Mr. WATKINS. Nothing from Justice. No written memorandum from Justice. We wanted to make sure that before we went ahead that at least we had checked all of the bases to see what the odds were.

The CHAIRMAN. Who was the meeting with at Justice?

Mr. WATKINS. I believe Mr. Elliot Siden with Dr. Snow, our executive vice president and chief legal officer.

The CHAIRMAN. Gentlemen, thank you very much for your testimony.

The next panel is coal shippers: Mr. Carl Bagge, National Coal Association; Kelvin Dowd, attorney representing the Eastern Coal Transportation Conference; Mr. W. Jeffrey Hart, president of Mapco Coals, Inc.

Mr. Bagge.

STATEMENTS OF CARL E. BAGGE, PRESIDENT, NATIONAL COAL ASSOCIATION; KELVIN DOWD, ATTORNEY, EASTERN COAL TRANSPORTATION CONFERENCE; AND W. JEFFREY HART, PRESIDENT, MAPCO COALS, INC.

Mr. BAGGE. Thank you, Mr. Chairman.

I have a prepared extensive statement. I will not read it but will submit it for the record.

The CHAIRMAN. You do not even have to ask.

Mr. BAGGE. My name is Carl Bagge. I am president of the National Coal Association. I just want to make a few brief points and then rely on my written statement.

Coal is the most important single commodity in terms of shipper interest here. In 1983 coal represented over 31 percent of all the commodities carried by Conrail and revenue, in terms of revenue. In that year Conrail carried almost 63 million tons of coal, originating 31.6 and terminating 56.3. It is all documented in the formal statement.

From a coal shipper's viewpoint, it is desirable to have the Conrail system continue to function as a third major eastern rail carrier capable of furnishing some intramodal and intermodal rail and water transportation alternatives for long haul shipments, in addition to the carriers included in the existing systems controlled by CSX and Norfolk Southern Corp. in the East and the South.

As yet, the National Coal Association as a trade association of the coal industry has reached no decision or any position with regard to the Secretary's choice of Norfolk Southern as purchaser of Conrail. Our transportation committee and our board of directors have this question under active review and study and will consider the matter thoroughly at its meetings which are ongoing. I just left a meeting in Houston on this very subject earlier this week analyzing the implications to the coal industry.

I sincerely believe that all shippers who are major stakeholders in the disposition of the Federal Government's interest in Conrail should have some reasonable amount of time, additional time to offer the Congress our views on the Secretary's choice of Norfolk Southern before the legislative process on this issue moves from this committee to the Senate floor.

There are two areas, two points I want to make, Mr. Chairman, and members of the committee of special concern to the coal industry. No. 1 is the expansion of market dominance, the captive shipper problem to coal, which is predominantly captive to a single carrier even in this region and in the total absence of rational regulation by the present Interstate Commerce Commission under the Staggers Act is obviously a paramount concern to us. The captive shipper problem under the Staggers Act as interpreted, we say totally, irrationally, and inconsistently with the intention of Congress in the 1980 Staggers Act, is one of pervasive concern to us.

The second point being the impact on transportation provided by other regional carriers which may be enhanced. We see the one redeeming quality to the Norfolk Southern acquisition of Conrail, the one and single redeeming quality superficially that we see may be the enhancement of the competitive position of the regionals, three of whom were here testifying on the earlier panel.

Now, these two concerns—No. 1, our concern with the captive shipper problem under the irrationalities of the ICC, and second, the problem with respect to the regional carriers—whether or not their competitive position will, in fact, be enhanced is the issue that we are looking at, trying to study right now if it benefits coal and thus redeems the merger. And we urge this committee to give those of us in the coal industry who are looking at this aggressively and as intelligently as we can a little more time to hear from the coal industry again before the committee completes its deliberations and sends this to the floor.

I believe it would be a regrettable mistake if the Federal government were to act precipitously in deciding how to dispose of its 85 percent ownership interest in Conrail. The rail system now is working well. It is working well for coal. It is providing competition for the coal industry today against other railroads where such competition can exist.

The tragedy is, Mr. Chairman, that where Conrail has attempted to be competitive in lowering, for example, a coal export rate to make the port of Philadelphia competitive and in terms of coal exports, under the way that the ICC administers the Staggers Act, the Chessie System was able to cancel a joint rate and through route by the Conrail system, denying my producer members who are in the CSX system the benefits of intramodal competition. We think this has to be changed, and that is why we have the cure legislation pending before the Congress now.

We would like to be permitted, Mr. Chairman and members of the committee, to examine more fully—we are doing it actively now, analyzing the consequences to coal, to my commodity of the Norfolk Southern in compliance with the Justice Department's recommendations to determine where in fact there are redeeming elements flowing from the acquisition by enhancing intramodal competition through strengthening the regional rail carriers.

We ask for a little additional time so we can approach this more intelligently than a precipitous action by this committee kicking this bill over to the Senate floor would permit. We are asking for 1 month, and we will be back and give you the real facts on this issue, how it affects coal in the region, and whether there are redeeming elements.

[The statement follows:]

STATEMENT OF CARL E. BAGGE, PRESIDENT, NATIONAL COAL ASSOCIATION

Mr. Chairman and Members of the Committee, my name is Carl E. Bagge. I am president of the National Coal Association. NCA represents coal producers, coal sellers, and other organizations associated with the coal industry. Our member companies are engaged in coal production in states where coal is mined in the East, the Midwest, and the West. Two out of every three tons of coal shipped are carried by the railroads, and 85 percent of all railroad coal tonnage is captive to a single rail carrier for all or part of coal's journey to electric utility and industrial plants and to ports for export or coastwise movement by vessels. Thus, the coal industry has a strong interest in the availability of competitive and efficient railroad transportation across our Nation.

Conrail is a vital part of our Nation's interconnected rail network, and originates, terminates, or carries the entire distance from mines to consumer destinations and ports, substantial amounts of coal produced or utilized by consumers in the Northeast and the Midwest. Therefore, the coal industry is a principal stakeholder, together with electric utility and industrial consumers of coal and electric utility ratepayers, in the decision of the federal government on the sale of its interest in Conrail. Accordingly, I warmly appreciate this opportunity to appear before the Committee to offer our views on this important subject.

NCA has followed closely the submission of several proposals to the Secretary of Transportation last year, and has had frequent contacts with the Secretary, the bidders, and other interested parties, notably other regional rail carriers operating in the vicinity of the Conrail service area. In December we decided that an approach advocated by Conrail's management; namely, disposal of the federal government's interest through public offerings of stock in the rail carrier with limits on the number of shares held by any particular shareholder, deserves serious consideration by the government as it reaches a final decision on the return of Conrail to ownership by the private sector.

I wrote the Secretary about our view in the hope that such an approach would be considered as the Secretary made her choice in regard to the sale of Conrail. However, as yet, NCA has neither favored nor opposed any specific approach, including the choice of Norfolk Southern Corporation announced by the Secretary this month. Our Board of Directors will be considering this question at its meeting next month; however, in any event it is clear that our key interests in this transaction are fivefold:

1. It is important to preserve, and if possible to enhance, competition among coal carriers so that market forces, not regulation, will effectively provide efficient and reasonably priced freight transportation services.

2. It is essential that in the short run, say a five-year period, there will be no break in the continuity of railroad service, both as to availability and quality of service, in a transition to new ownership.

3. Further, it is vital that competitive and efficient railroad operations will be continued in the long run on the Conrail trackage, averting unwarranted termination of effective access to sound rail freight transportation services through conversion of railroad rights-of-way, trackage, and rail-related facilities to non-transportation uses and sale of rail equipment required to provide efficient rail service.

4. With the ability to negotiate transportation contracts now explicitly lawful and encouraged under provisions of the Staggers Rail Act of 1980, it is highly desirable that the momentum shown by Conrail in recent years toward contracting multi-year rates and services continue unabated, and accelerated in future years.

5. It is strategically critical that there be no diminishing of rail-to-water linkage now furnished by Conrail to coastal ports and to the inland waterways system, notably for coal movements to Ports of Baltimore and Philadelphia and facilities of the Port Authority of New York and New Jersey, as well as inland connections such as the Duquesne terminal at Pittsburgh.

Conrail's role as a coal carrier is underscored by its 1983 statistics which show that coal was 31.1 percent of all commodity tonnage carried by Conrail in revenue service. In that year, Conrail carried 62.9 million tons of coal, and originated 31.6 million tons and terminated 56.3 million tons of coal, figures that show Conrail's importance in providing coal transportation services involving movements from mines both within and outside of its service area.

Our contention that the public stock offering approach advocated by Conrail's management should be carefully considered by the Federal government is bolstered by proven performance shown by these statistics and an aggressive marketing of transportation services as well as gains in reduction of costs which have made Conrail a profitable rail carrier today. Certainly today's business at Conrail is much different than in the late 1970's from the perspective of financial health, noting that last year it is estimated that Conrail earned about $500 million in revenue, an impressive circumstance compared to 1978 when Conrail reported a loss of $400 million. From a shipper's viewpoint, of course, it is also meritorious to have the Conrail system continue to function as a third major Eastern rail carrier capable of furnishing some intramodal and intermodal rail-and-water transportation alternatives for long-haul shipments in addition to the carriers included in the existing systems controlled by CSX Corporation and Norfolk Southern Corporation in the East and the South.

This is not meant to say that the Secretary's choice, Norfolk Southern Corporation, is necessarily objectionable. Much of NSC's trackage essentially is end-to-end with Conrail's trackage, although there are some exceptions as noted in a January 29, 1985 letter to the Secretary from the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice. Presumably such difficulties could be worked out through divestiture or granting rights to use certain tracks and facilities if NSC were to acquire Conrail. Our two greatest concerns about the Secretary's recommendation are:

1. The transacton would expand NSC's market dominance over coal movements, a matter of serious implications to coal shippers because the Interstate Commerce Commission fails to implement railroad regulation incorporated in the Interstate Commerce Act, as amended, in a manner that protects captive shippers from rate abuse. The ICC constantly leans in the direction of capturing maximum revenues from those who have no competitive transportation alternatives, particularly coal shippers. This is contrary to the law and must be corrected; yet faced with this problem, it could be most troublesome to condone a broadening of railroad market dominance. Furthermore, our wariness is heightened significantly with regard to this transaction when the same Secretary of Tranportation that chooses NSC is oblivious to captive shippers' problems and regularly through her Department's representatives, endorses ICC's decisions.
2. Our second area of concern is what impact NSC's acquisition of Conrail would have on other regional rail carriers such as the Bessemer & Lake Erie Railroad, the Monongahela Railroad, the Pittsburgh & Lake Erie Railroad, and the rail carriers controlled by Guilford Transportation in the Northeast. These rail carriers furnish access to coal markets and to important connections with Great Lakes' carriers which could be lost if NSC were unwilling to enter into agreements on use of selected trackage involved in a sale of Conrail to NSC. Admittedly, such difficulties could be overcome with mutually acceptable conditions imposed on the transfer of federal ownership to NSC, a matter which deserves careful thought.

In summary, as yet NCA has reached no decision on any position in regard to the Secretary's choice of NSC as purchaser of Conrail. Our Board of Directors has this question under review and will consider the matter thoroughly at its meeting next month. I sincerely believe that shippers who are major stakeholders in the disposition of the federal government's interest in Conrail should have some reasonable amount of additional time to offer the Congress our views on the Secretary's choice of NSC before the legislative process on this issue moves from Committee consideration to Senate floor debate. The Secretary's February 5 announcement was little more than three weeks ago; surely such a significant action, without intent to procrastinate, deserves more time for evaluation.

Our two areas of special concern—the expansion of market dominance in the absence of rational regulation, and the impact on transportation provided by other regional rail carriers--undercore why we urge the Committee to give us a little more time and to hear from us again before the Committee completes its deliberations. I believe it would be a regrettable mistake if the federal government were to act precipitously in deciding how to dispose of its 85 percent ownership interest in Conrail. The rail system now is working well; the area it serves needs efficient and competitive rail freight transportation for the long run; and whereas it is appropriate and desirable to return Conrail to private ownership, the value of making the right decision for all concerned—the government, carriers, shippers, and the public—calls for a full and complete assessment of the Secretary's recommendation.

Thank you for allowing me to appear before you at this time. I hope you will permit me to supplement my comments after the NCA Board of Directors meets next month.

[The following information was subsequently received for the record:]

NATIONAL COAL ASSOCIATION,
Washington, DC, March 27, 1985.

Hon. JOHN DANFORTH,
Chairman, Committee on Commerce, Science and Transportation, U.S. Senate, Senate Dirksen Office Building, Washington, DC.

DEAR MR. CHAIRMAN: During the hearing held on February 28 regarding the Department of Transportation's sale of Conrail, I committed to let you know the outcome of the NCA Board of Directors' discussion of the Conrail issue at its March Board meeting.

The NCA Board voted to reaffirm NCA's support of competition and adequate captive shipper protection when evaluating any proposal to return Conrail to the private sector. However, the Board decided to remain neutral in regard to any specific proposal.

I would like to thank you for allowing me the opportunity to appear before your committee and state the coal industry's concerns regarding this issue. We will maintain communications with you and your staff over the next few months while Congress continues its consideration of the Conrail sale.

Sincerely,

Carl E. Bagge,
President.

The Chairman. Mr. Bagge, this is the hearing, so we would hope that any additional information you care to submit would be in writing, and also that you could accelerate the process. I think you have a pretty good idea now what the arrangement is. Obviously, we would like to hear from you, and would welcome any input that you would have, but we do not want to just keep the process boiling.

Mr. Bagge. What it takes is a study of whether or not there is enough traffic where there will be—God knows, I took a great deal of comfort from the fact that we had railroad executives talking in favor of competition. I took a great deal of comfort from that. I did not know that they were there.

The Chairman. We would certainly like to hear from you before the markup.

Mr. Bagge. Thank you. We will submit it in writing. Thank you very much.

The Chairman. If we could, we would markup the bill next week. However, that might be before we can get it all together.

Mr. Bagge. Then you are going to act without knowing what the facts are from the coal standpoint, in my view.

The Chairman. Well, we hope you all would not be too leisurely in your analysis.

Mr. Bagge. We will try.

The Chairman. Mr. Dowd.

Mr. Dowd. Thank you, Mr. Chairman, Senator Rockefeller, Senator Trible.

I represent the Eastern Coal Transportation Conference, which is an association of 21 small and medium-sized coal producers and transportation consumers in West Virginia, Kentucky, Virginia, Pennsylvania, Ohio, and Florida.

Our position is very simply stated. We believe that approval of the sale of Conrail to the Norfolk Southern Corp. would be an unmitigated disaster for the interests of coal shippers in the East.

With the Interstate Commerce Commission in its current state of suspended animation, Conrail is effectively the only potential competitive check on CSX and Norfolk Southern in the east. Coal shippers are dangling from a thread, and the Department of Transportation has come before this committee and effectively offered Norfolk Southern a pair of scissors.

We believe that the approval of this sale would be wholly inconsistent with the public interest and with the antitrust policies of the United States.

A great deal has been mentioned about the Department of Justice report, the nine-page license, if you will, to Norfolk Southern; and I would like to make a few observations about that.

First, we agree with the Department that a sale of Conrail as is would be a pure violation of the Clayton Act. We strongly disagree, however, that you can remedy that problem by granting trackage rights or by divesting a few lines.

With all due respect to Guilford Transportation and the Grand Trunk and other regional carriers; we have a great deal of respect for their trying to compete with the large systems today, there is no way that a regional carrier, regardless of the extent of the trackage rights it has, can step into the shoes of Conrail and provide the sort of direct, geographic, upstream or downstream competition, as well as the general downward pressure on the overall eastern rate structure, that Conrail's presence as an active competitive force provides. It simply cannot happen. You could have a thousand miles of trackage rights, but unless you are large enough and have enough capital and a presence in the region to make full use of those rights, you might as well not have them at all.

The Department of Justice conclusions, in our view—and we have studied the report—are based upon a sketchy and wholly inadequate analysis of the competitive consequences of a merger of this magnitude.

For one thing, the report takes a very narrow view of the markets which are relevant for consideration. The Department, for example, ruled out any market in which Conrail and Norfolk Southern together do not have at least 50 percent of the traffic, and where each of them did not have at least 10 percent of the traffic.

That was done without any real explanation. Those figures were essentially unsubstantiated in the report, and moreover, there was no consideration given to the makeup and the number of participants that would control the remaining portions of the traffic. What that does is effectively focus the analysis solely on those areas where Conrail and Norfolk Southern compete directly. There is no examination of the impact of the sale of Conrail on present-day competition between Norfolk Southern and, say, CSX. There is no examination of the upstream competition that the presence of Conrail provides from origin movements of coal from, for example, West Virginia or Kentucky.

For coal shippers, however, it is this indirect competitive effect, more than the direct point-to-point competition, that is important with regard to Conrail. A perfect example is the northeastern utility market. Northeastern utilities are converting to low-sulfur coal. There is a demand for low-sulfur coal. A good portion of it is not available in origin service on Conrail, but Conrail delivers that coal. The origin of that coal is in southern West Virginia and in eastern Kentucky in areas that are served by CSX and Norfolk Southern.

Today, with Conrail independent, a friendly connection will exist for both of those origin carriers, and the shipper in New England can choose his coal based upon the best delivered price from those origins. If you sell Conrail, the delivering carrier, to one of the origin carriers, the friendly connection for the competitor will disappear. The coal producers that are local to the competitor can no longer compete for traffic to the northeast utility, and the northeastern utility has lost its origin competition for its coal source.

Now, a second problem—and this is particularly acute to us—is the complete absence of any mention of the impact of the merger on coal. In the Department of Justice report the word "coal" appears twice, in a computer printout in the appendix to the report. Otherwise, there is no consideration given to coal, despite the fact that it is effectively the revenue backbone of the eastern rail structure and is the quintessential rail captive commodity in the eastern part of the United States.

In 1983, for example, some 78 percent of the traffic that was handled by Conrail in West Virginia was coal traffic. Yet, there is not a single word about coal anywhere in the report. U.S. export coal producers today are priced out of the world market because of high rail rates and ineffective competition, but there is no meaningful mention of coal anywhere in the report.

The Department of Justice has given its blessing to the largest rail merger in the history of the United States without one word regarding the impact of that merger on the most important commodity, from a revenue standpoint, carried by rail.

To be perfectly honest, it boils down to this: The Government cannot have it both ways. If this committee and the Congress are going to bless the sale of Conrail to Norfolk Southern, then we believe that you have to openly acknowledge a willingness to allow a serious and irreversible decline of effective competition in the East. If, on the other hand, the competition that presently exists, which we consider minimal, but is nevertheless at least there now, is going to be preserved, then the Department of Transportation proposal must be rejected.

[The statement follows:]

STATEMENT OF KEVIN J. DOWD ON BEHALF OF THE EASTERN COAL TRANSPORTATION CONFERENCE

Mr. Chairman and members of the Committee. My name is Kelvin J. Dowd, and I am counsel to the Eastern Coal Transportation Conference. ECTC is an association of twenty-one small to medium-sized coal producers, consumers and property owners located East of the Mississippi River, predominantly in the states of West Virginia, Pennsylvania, Virginia, Ohio and Kentucky. It is the successor to the Property Owners' Committee, an organization which was founded in 1926. I appreciate this opportunity to appear before you today and, on behalf of ECTC, address a matter which is of critical importance to rail shippers across the Eastern United States: the proposal by the Department of Transportation to sell the United States' ownership interest in Consolidated Rail Corporation to the Norfolk-Southern Corporation.

We submit that legislative approval of DOT's recommendation would be disastrous insofar as the interests of the shipping public are concerned. An independent Conrail today stands as the only barrier to a complete duopoly over rail transportation in the East. Under continued independent control, a healthy Conrail can provide an invaluable competitive check on the market power possessed by the two dominant Eastern rail systems. Controlled by one of these systems, however, Conrail would become a weapon, increasing concentration in an already over-concentrated transportation market, and stripping Eastern rail shippers—particularly coal shippers—of the minimal bargaining power they presently possess.

1. THE EASTERN COAL TRANSPORTATION MARKET IS HEAVILY CONCENTRATED

Over the past several years, rail shippers in the East have borne witness to a steady increase in the concentration of transportation market power in fewer and fewer hands. The merger of the Norfolk & Western and Southern Railways, followed by the formation of the giant CSX conglomerate, have bred an atmosphere of two-carrier market dominance over much of the volume rail traffic in the East.

In many areas, these two mega-carrier systems do not compete with one another. Rather, each exerts near-total control over traffic originating at points on its lines, leaving the other unfettered to do the same. A good example of this parallel behavior is in the area of export coal movements. Today, virtually no competitive joint rates are published for shipments from mines located on a CSX carrier to a Norfolk-Southern export terminal, and vice-versa. On the other hand, single line rates from mines on these carriers' lines to their own terminals are almost identical, and have remained so for some time. The effect is to force export shippers or producers with mines located on CSX to ship via CSX to a CSX-owned terminal. The same holds true for sources located on Norfolk-Southern. The result, confirmed by the Interstate Commerce Commission in its 1983 decision regarding the exemption of export coal transportation from regulation, is an absence of competition and an effective market division: today, 81% of U.S. exports of metallurgical or "coking" coal move via CSX. For its part, Norfolk-Southern controls 93% of the shipments of export steam (e.g., utility) coal. The only loser, of course, is the shipper/producer—the carriers do not suffer in the least from this "hands-off" approach to competition.

Recently, these carriers have moved to expand the reach of their market power into other transport modes. CSX's acquisition of American Commercial Barge Lines, one of the Nation's largest inland waterway carriers, and Norfolk-Southern's ongoing efforts to obtain control of North American Van Lines cannot help but further limit the rate and service alternatives available to Eastern coal and other bulk commodity shippers.

2. THE VALUE OF CONRAIL AS AN INDEPENDENT COMPETITOR

To be sure, many volume shippers presently cannot avail themselves of the Conrail alternative, and are already captive to one of the dominant systems. For a substantial segment of Eastern traffic—including particularly coal traffic—however, Conrail represents one of the few sources of potential transportation competition available in an otherwise divided and conquered market.

Conrail's presence in the East as an independent force ready to compete for traffic has produced a number of benefits for shippers that otherwise would be at the mercy of CSX or Norfolk-Southern. A shipper experiences heightened willingness to contract for shipments on reasonable terms on the part of Norfolk-Southern and CSX when that shipper can turn to competitive rate and service terms via Conrail. Even where shippers do not enjoy direct, common point competition between Conrail and one of the other major carriers, the downward pressure exerted on the overall Eastern rate structure by Conrail's involvement in markets otherwise dominated by Norfolk-Southern and CSX produces an indirect, positive effect on prevailing rates throughout the region.

Conrail has also been instrumental in efforts to develop the Port of Philadelphia as a major outlet for U.S. coal exports. Through rate discount programs and other incentives, Conrail has effectively promoted Philadelphia as a viable alternative to the Baltimore and Tidewater facilities dominated by CSX and Norfolk-Southern for many export shippers.

Of particular importance to ECTC and its members, however, has been Conrail's innovative marketing style, especially in the area of small shipper relations. Frequently, the rate and service benefits incident to trainload or other high volume movements are unavailable to smaller coal shipper/producers in states such as West Virginia, who might not be able to meet substantial minimum volume requirements from individual mine sources. This results in their coals becoming less competitive, since buyers must pay (or absorb in the delivered price) higher single-car or multiple-car rates. The past few years, however, have seen Conrail moving to accommodate smaller shipper's needs, through the estabishment of reduced rates from common gathering points (which allows a number of shippers to pool their own limited resources), the extension of loading times for trainload movements, and the maintenance of flexibility in the negotiation of service contracts.

There is no question but that Conrail has filled an invaluable role as a tempering force in the deregulated environment ushered in by the Staggers Rail Act of 1980. As administered by the current members of the Interstate Commerce Commission, the Act has granted market dominant rail carriers extensive rate and service freedom. Small shippers, who typically lack substantial bargaining power vis-a-vis carriers such as CSX and Norfolk-Southern stand exposed to higher single-line rates, route closings, joint rate and reciprocal switching cancellations, restrictive or burdensome service rules and other market abusive practices under this regime. Smaller, entrepreneurial coal producers have played a major part in the U.S. Eastern coal industry throughout its history. In the current environment, however, their very survival is threatened by the trend toward increased concentration in rail transportation market power. Today's Conrail is a "finger in the dike" for many of these producers and shippers, and its preservation as an independent competitor in the East is therefore critical.

3. THE NEGATIVE IMPACT OF A SALE TO NORFOLK-SOUTHERN

A sale of Conrail to the Norfolk-Southern Corporation would, to be sure, take the U.S. Government out of the railroad business. The price that would be paid by Eastern coal and other bulk commodity shippers and the consumers they serve, however, would far outweigh any public benefit.

According to a study released by the Grand Trunk Corporation, the combination of Norfolk-Southern and Conrail would create by far the largest transportation enterprise in North America. Its combined annual revenues of over $6 billion would be over 40% greater than those of the Union Pacific and Burlington Northern—two huge and powerful Western systems—combined. The 32,000-mile rail network would stretch from New England to Florida, and from the East Coast to the Mississippi River and beyond, and would leave over 5,500 shipper stations entirely without competitive rail service.

The problem does not end with the mammoth size of the resulting company, however, or with the fact that such a transfer effectively would take a market with three major participants and transform it into a legalized duopoly. A sale to Norfolk-Southern would be followed by the wholesale elimination of "duplicative"—otherwise known as competitive—lines and routings. Not only will this "rationalization" program result in worker layoffs and service abandonments, it will take many shippers among them several ECTC members, that presently enjoy the benefits of a competitive market and render them wholly captive to a single, gargantuan railroad system with little or no fear of either regulation by the ICC or competition from other carriers. While this is certainly a prescription for increased profitability on the part of Norfolk-Southern, it is a death knell for shipper and consumer interests.

Equally serious will be the blow to innovative marketing and accommodation of small shipper concerns resulting from the loss of independence on the part of Conrail's management—if not the loss of that management altogether. No longer would Conrail be operated in the long-term interests of its stockholders (the taxpayers) and the shipping public. Instead, it will become a subsidiary profit-center, operated in the parochial interest of Norfolk-Southern and its stockholders. Put simply, now that Conrail is back on its feet, the benefits of its success will flow to those who had nothing to do with Conrail's recovery. Conrail's shippers and employees, as well payers who helped finance that recovery, will come away emptyhanded and—particularly in the shippers' case—worse-off than before the sale.

One specific commodity example may be illustrative of one aspect of the market impact—both direct and indirect—of a sale to Norfolk-Southern. Currently, the trend in the Northeastern utility coal market is toward the use of low sulfur coal, which is not available from most Conrail origins but is mined from locations served by CSX and Norfolk-Southern (one of the areas where these two systems still compete). As delivering carrier, Conrail today will connect with and serve shippers originating traffic on either, with delivered prices determined on the basis of market demand and competition. Should Conrail be acquired by Norfolk-Southern, however, the situation can be expected to change dramatically. CSX doubtless would lose its "friendly" delivery connection to the Northwest utilities, precluding producers on its lines from competing with Norfolk-Southern coal for sales. At the same time, the utility consumers would lose their choice of sources; coal effectively would be available exclusively from sources served by Norfolk-Southern. Both the supply *and* the consuming markets would suffer a reduction in competition, with the only winner being Norfolk-Southern. It is unlikely that the increased potential for profit would be shared with its captive coal producers.

4. CONDITIONS AND COVENANTS ARE INSUFFICIENT TO PROTECT SHIPPERS AND CONSUMERS

It has been argued that so long as the Government attaches the right "conditions" to the transaction, a sale to Norfolk-Southern could be completed without doing harm to the competitive balance in the eastern market. In particular, this is the conclusion reached in nine-page report prepared at the request of Transportation Secretary Dole by the Antitrust Division of the U.S. Department of Justice. While we agree with the Justice Department's threshold statement that a transfer without conditions would produce a merger in blatant violation of the Clayton Act, we strongly disagree with the view that all significant anti-competivie consequences can be avoided through the divestitures and trackage rights grants proposed in the report.

First, on a general level, the competitive influence that is exerted by Conrail is possible specifically because of its size, independence, and the location of its lines as the main source of rail deliveries to the Northeast. One could not make up for the loss of a single, consolidated major competitor simply by granting selected trackage rights and gateway access to a number of small, regional carriers that lack the physical capacity—even under the best of circumstances—to go toe-to-toe with the CSX and Norfolk-Southern systems. More particularly, however, there are significant deficiencies and omissions in the Justice Department's analysis which seriously impugn the credibility of its conclusions.

To begin with, the scope of the Department's analysis of competitive impacts is overly narrow. According to the report, the Department confined its study to those combined geographic/product markets where (a) Conrail and Norfolk-Southern together controlled over 50% of the relevant traffic; and (b) each company's respective market share was in excess of 10%. Thus, a market where the two together controlled, say, 48% of the traffic was wholly ignored, without reference to the number and size of the competitors collectively possessing the other 52%.

Obviously, the deleterious effects on competition flowing from a merger which creates a single 48% share in a market where 13 other companies control only 4% each are far different (and, perhaps, greater) than would be the case where the remaining power is concentrated in the hands of two firms with, say, 26 percent each. While an analysis employing the so-called Herfindahl Index would probably call for a challenge in either case,[1] in the latter it is at least true that the remaining competitors (with 26 percent shares) would be better-equipped to compete head-to-head with the merged firm. The same would not be true under the former scenario. In any case, this type of scrutiny—a standard and critical part of the Antitrust Division's methodology in private merger studies—appears to be wholly absent from the truncated Conrail analysis.

Additionally, the Department's report focuses almost solely on the effects of a Conrail/Norfolk-Southern combination on competition between these two firms. Little meaningful consideration is given to the impact on pre-merger competition between Norfolk-Southern and other carriers. While the Department admits that future traffic diversions are "extremely difficult" to estimate, it nevertheless dismisses the potential impact of such diversions as insignificant, or even irrelevant. Instead, it touts the offsetting "benefits" of increased singleline service, without regard to, e.g., the increased potential for discrimination or the likelihood of unreasonable rate increases single-line traffic under the regime of *de facto* market dominant rate deregulation currently sanctioned by the ICC. Thus, for example, the problem of upstream competition outlined earlier with regard to Northeastern utility and shipments wholly escapes the reach of the Department's methodology.

Yet another omission is any meaningful explanation of the criteria relied upon by the Department in developing its "screening procedure," whereunder the Department wholly excluded consideration of markets where "non-rail competition appeared to be significant," where "the total revenues affected were small," or where the "major shipper in the market supported the merger." The Department should have stated plainly, in nonconclusory terms, why it was appropriate to employ these somewhat arbitrary exclusions in examining a transaction which, if completed, would result in the creation of the largest rail transportation conglomerate in the United States.

Finally, the Department's report makes no mention whatsoever of the acquisition's potential impact on coal—which is the backbone of the Eastern railroads' traffic base—even though ECTC and other interested parties invested substantial time and effort gathering relevant data for this purpose. Export coal alone ranked as the third largest eastern rail commodity group in 1983, yet there is no discussion of the impact of the proposed combination on export coal shippers, who already find themselves priced out of the world sales market by high rail rates and restrictive routings. This failure may be traceable to the Department's over-emphasis on direct competition, or its unjustified concern for the "practicability" of divestitures. Whatever the reason, however, it should not be permitted to go unexplained.

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[1] In the first (assuming a 20%/28% split of the 48% share in question), a pre-merger Index of 2536 (indicative of a highly concentrated market) rises to 3656 after the merger. In the second, the Index almost doubles, from 1392 to 2512.

There are a number of more technical problems with the Department's analysis, which further detract from the credibility of its final conclusions. As a "bottom line," however, it appears clear that the Department's primary goal was not an objective determination of whether a Conrail/Norfolk-Southern combination would be consistent with the public interest. Rather, the Department seems to have embarked on its study in an effort to find ways in which to justify a predetermined conclusion: that the acquisition of Conrail by Norfolk-Southern should be permitted. We submit that this "cart before the horse" approach is improper in the context of the critically important decision now facing this Committee and the Congress, and inconsistent with the Antitrust Division's charge as the Government's sentinel against commercial tranactions which threaten harm to competition.

5. CONCLUSION

The Government cannot have it both ways. If the Congress is to approve a sale of Conrail to Norfolk-Southern, it must openly acknowledge its willingness to accept a serious and irreversible deterioration of transportation competition in the East. If, on the other hand, present levels of competition (levels which we consider to be but a bare minimum consistent with the public interest) are to be maintained, DOT's proposal must be rejected.

The fallout from a sale of Conrail to Norfolk-Southern would include a dramatic loss of head-to-head and indirect transportation competition in the East, extensive service abandonments and job layoffs, a severe increase in the concentration of an already over-concentrated market, and a further deterioration of the already desperate position of many small coal and other bulk commodity shippers. We strongly urge this Committee to reject legislation which would implement the proposal by the Department of Transportation to sell the Government's interest in Conrail to the Norfolk-Southern Corporation.

I thank you once again for allowing ECTC the opportunity to appear before you today, and would be happy to respond to any questions.

The CHAIRMAN. Thank you.

Mr. Hart.

Mr. HART. Thank you, Mr. Chairman.

My name is Jeffrey Hart. I am president of Mapco Coals, Inc. Our company operates coal mines in Kentucky, Maryland, Illinois, and is a subsidiary of Mapco, Inc., a diversified energy company. In 1984 we produced 8.6 million tons of coal, and all of our mines are served by either the Norfolk Southern or CSX.

We favor the acquisition of Conrail by Norfolk Southern for principally two reasons: one, a combined Norfolk Southern-Conrail will be able to offer improved service over a larger geographic area; and two, such a combination will ensure a financially sound Conrail.

At present we are for all intents and purposes excluded from marketing Conrail-served customers in the Northeast and some areas of the Midwest. Unfortunately, the practical problems encountered in trying to arrange a rate involving more than one railroad has generally limited us to dealing with customers that are on the same railroad that serves our mines.

Let me make it clear that I am not accusing the railroads of being unreasonable. On the contrary, it has been our experience that railroads generally recognize that they are partners in the coal business and work with us to promote the use and therefore transportation of coal. The difficulty of interlining coal from one carrier to another is a problem inherent in the system. Some of the problems are agreeing on the proper division of revenues, working out service terms acceptable to all parties involved, and deciding on the cost allocation when traffic is switched from one railroad to another. These are all legitimate business problems which decrease the likelihood that coal will move over a joint route at a rate which is competitive with coal moving over a single railroad.

If Norfolk Southern and Conrail are combined, the single system will be able to offer transportation opportunities which are currently unavailable to Mapco and other coal producers. The railroad mergers of the past several years offer dramatic proof of this point. Both shippers and the railroads have benefitted from the efficiencies resulting from enlarging the territorial reach of a railroad. And we expect a Norfolk Southern-Conrail system to produce similar advantage to shippers located on the combined system.

In our particular case, we see the chance to market our coal in parts of the Midwest and Northeast. Obviously, this would benefit us, but it would also benefit the utilities in those areas by offering them another source of supply. The more choices a utility has available to it, the more likely it is that that utility can obtain a lower price, and that, of course, translates into lower monthly bills for that utility's customers.

Based on our marketing analysis and our experience with transportation rates offered by a single railroad system, we feel confident that we will be able to work with a combined Norfolk Southern-Conrail and become a competitive factor in parts of the Midwest and the Northeast.

The second reason that we support Norfolk Southern's acquisition of Conrail is that we see such an acquisition as the best guarantee that Conrail will endure over the long run. Integrating Conrail into the Norfolk Southern system means that Conrail will have the benefit of Norfolk Southern's financial strength and operating expertise and will have its territorial reach expanded to areas served by the Norfolk Southern. In our view, a purchase by Norfolk Southern will ensure a bright future for Conrail.

As I have previously stated, we want our coals to become competitive in the areas served by Conrail. We want to enter into transportation contracts which will allow us to sell our coal in those areas, and that means we want to deal with a Conrail which is healthy now and will be healthy 20 years from now.

For these reasons we strongly support the sale of Conrail to the Norfolk Southern. I appreciate this opportunity of being able to state our views. Thank you.

The CHAIRMAN. Mr. Hart, thank you.

Gentlemen, thank you.

I think you have done a pretty good job of setting out your positions: one yes, one no, and one undecided.

Mr. BAGGE. That is about par for coal, Mr. Chairman.

The CHAIRMAN. I also think you have done a very good job of setting out the pros and cons of this proposal. I have no questions.

Mr. BAGGE. Could I make just one more statement? In terms of timing, you know, we were not aware until this last weekend of the fact that the Norfolk Southern reached an agreement with the P&LE and the Guilford people. In fact, as they characterized it to us with my group in Houston, TX, just on Tuesday afternoon, that you cannot even characterize what they have done with the Guilford group as a final agreement yet.

So we are looking at a situation that is so fluid, the negotiations are still ongoing, and it was only over the weekend that they reached it with some of these regionals. And therefore, I am pleading again for us to try to analyze something we were just made aware of on Monday.

The CHAIRMAN. Right. I understand fully your point, and we do not want to just zip along without giving serious consideration to all the points raised. On the other hand, we do not want to just drag the thing out forever because, as the testimony indicated earlier in the day, it really is not fair to the parties involved, the employees, the shippers, or anyone else who is going to be left up in the air.

So my hope is that we can move on this bill expeditiously, but not in a rush-rush fashion. We do not yet have a markup date that is set. I am going to have to talk to Senator Hollings about this and see if we can arrange something. I think that, as I understand it, it is doubtful whether the Senate is going to be in the week after next. Whether that means that the Commerce Committee is not going to be in, I do not know. It probably does. It probably means we would not be able to get a quorum. Next week, at least 3 days next week the Budget Committee is going to be marking up the budget resolution, and several of us are on the Budget Committee; so it will be a matter of just working out a date.

But I hope that when we do get the date, we are in fact ready to go, and that we are not going to be just waiting around for more and more analysis.

My own judgment is that this acquisition has been a matter which has really received a lot of analysis. It has been in the works since 1981. The Department of Transportation has been looking into it really in almost a fishbowl atmosphere. Everyone has been aware of who the parties are and what the issues are.

So I would hope that your association acts with reasonable dispatch in putting together its thoughts. I assure you we will look at whatever your analysis is with very great interest.

Gentlemen, thank you very much.

Finally, a general shipper panel. Mr. Ronald M. Jacobson of Rohm & Haas; Mr. Reeder Miller, A.E. Staley Manufacturing Co.; Mr. Raymond Casey, Landmark, Inc.; Mr. Bruce Gordon, B.F. Goodrich Chemical Group; and Mr. Charles F. Wilkins, Ford Motor Co.

Gentlemen, let me thank you for being here and for sticking it out, and for being willing to be here at this unreasonable hour. I very much appreciate it. It is an unreasonable hour for a hearing, and I do not want to make this a regular practice of the Commerce Committee, but I did think it best if we could just get through the hearings today rather than reschedule people. Oftentimes when we put hearings together, our eyes are bigger than our stomachs and even bigger than our capacity for sitting in one place for a long time. But I appreciate your forbearance and your willingness to stick it out.

Mr. Jacobson, would you like to start?

STATEMENTS OF RONALD M. JACOBSON, LOGISTICS MANAGER, ROHM & HAAS; REEDER MILLER, VICE PRESIDENT, CORPORATE TRANSPORTATION, A.E. STALEY MANUFACTURING CO.; RAYMOND R. CASEY, VICE PRESIDENT, LANDMARK, INC.; BRUCE T. GORDON, DIRECTOR OF TRANSPORTATION, B.F. GOODRICH CHEMICAL GROUP; AND CHARLES F. WILKINS, MANAGER-TRANSPORTATION ANALYSIS AND PROCUREMENT DEPARTMENT, TRANSPORTATION AND TRAFFIC OFFICE, FORD MOTOR CO.

Mr. JACOBSON. My name is Ron Jacobson. I am with the Rohm & Haas Co. We are a speciality chemical company based in Philadelphia. We are a major shipper in the Conrail system. We ship approximately 2,500 carloads of bulk chemicals per year between the gulf coast area of the United States and the Philadelphia area.

Certainly the return of Conrail to the private sector has been a subject of great interest to us because the traffic that we ship is captive to the Conrail system at all locations, either at the origin or the destination. We have been very concerned that the sale of Conrail would be conducted in such a way that it would meet some broad-based goals to maintain long-term economical, viable service to the Northeast, to fulfill all of the existing contracts and agreements that Conrail had on the books, maintain the Conrail management, and to assure the breadth and continuity of an independent Conrail system.

As a corporate citizen of Philadelphia, we certainly were very concerned about any move that would create financial hardship on the employees, the community or the support industries that have helped make Conrail a very successful railroad.

In general terms I would have to agree that the Department of Transportation has used the same criteria and has set the same goals for the process of offering Conrail for sale to interested bidders. The fault, however, lies in the conclusion that DOT has reached in the selection of Norfolk Southern as a recommended buyer.

In our opinion, the sale to Norfolk Southern is really a merger, and a merger of two major east coast railroads that would result in the Nation's largest single railroad.

Several things are wrong with this merger, in our opinion, as proposed by DOT. It is not a merger of survival. A merger of survival could be tolerated because it would certainly be in the best interests of shippers by preventing the loss of important rail service.

This merger is inconsistent with established merger guidelines, and the simple disengagement or sale of a small number of rail corridors would not be sufficient to make this satisfactory in terms of those merger guidelines.

There is no question that the reduction of three railroads to two is going to reduce competition, and this is inconsistent with the needs of the shipping community and the general public.

In general terms, mergers between two major railroads always lead to significant efficiency improvements. It is also quite true that these significant efficiency improvements are generally not placed in the hands of the shippers in terms of reduced rates, but rather absorbed by the railroads in terms of increased profits.

Another significant part of efficiency improvements is the need to eventually reduce significant amounts of administrative and sales staff. We believe this particular aspect of the merger itself can be very damaging to the Delaware Valley of Pennsylvania where there are approximately 7,000 Conrail employees involved in activities at Conrail headquarters or Conrail shipping yards. The loss of these jobs, either by transfer, attrition, or by replacement could represent a loss of somewhere in the neighborhood of $8 million per year in direct taxes to the city of Philadelphia alone.

We do not feel that the creation of this new megarailroad by the merger of Norfolk Southern and Conrail, which will effectively place a controlling interest in the hands of one railroad for the five major gateways between the West and the gulf coast and the east coast, namely the gateways of New Orleans, Memphis, Kansas City, and Chicago, is in the best interests of the shipping community.

Particularly dependent on these gateways are the petrochemical, pulp, paper, and mineral industries that rely on heavy flow of goods in and out of the gulf coast and the West to the Northeast.

There are many alternatives to the sale of Conrail to Norfolk Southern, one of those being the public sale. We believe that the public sale from the outset did not receive complete analysis by the Department of Transportation, and yet, it does provide us with a maintenance of competition between three railroads, it maintains the Conrail management in place, and would not disrupt the shipping community by transferring rail corridors from the Conrail system or the Norfolk Southern system to short-line railroads. Certainly there are other alternatives that could be reexplored. And if the bidding process was reopened, it is possible that we would not support a public sale. But in light of two rail alternatives available to us—Norfolk Southern, and the other alternative being the public sale—we clearly think that the public sale is the superior alternative.

Thank you.

[The statement follows:]

Statement of Ronald Jacobson, Logistics Manager, Rohm & Haas Co.

THE SALE OF CONRAIL

The return, by sale, of Conrail to the private sector must be accomplished in a manner that achieves certain broad based goals. These goals are to:

(1) Maintain long term, economically viable, and reliable service to and from the northeastern region of the United States,

(2) Insure the enhancement and continuation of rail-to-rail competition through the free interchange of traffic among competing railroads under reasonable commercial conditions,

(3) Insure fulfillment of all existing Conrail contracts, agreements and obligations,

(4) Maintain the continuity of the Conrail management team that has so successfully developed a railroad known for its excellent service, responsiveness to shipper's needs and creative marketing,

(5) Insure the breadth, continuity and independence of the Conrail system,

(6) Place priority on the interests of the shipping community over the desire to receive a high price or effect a quick sale, and

(7) Avoid creating financial hardship on the employees, communities and support industries that have sacrificed and cooperated in the effort to make Conrail a successful railroad.

In general terms, the Department of Transportation has used the same criteria and has had the same goals for its process of offering Conrail for sale to interested bidders. The fault, however, lies in the conclusion that DOT has reached in the selection of Norfolk Southern as the recommended buyer.

SALE VS. MERGER

The recommended sale of Conrail to Norfolk Southern is, in essence, the merger of two profitable, major, Eastern railroads. It will result in the creation of the nations largest single railroad.

Several things are wrong with this merger as proposed by DOT.

It is not a "merger of survival" which could be in the interests of the shippers by preventing the loss of important rail service—as was the case with the formation of Conrail itself.

As a merger it is inconsistent with established merger guidelines and would be opposed or at least more thoroughly scrutinized by federal agencies, the shipping community, and the rail industry and would take years to consumate if allowed at all.

As a merger that reduces the number of competing railroads it is by no means pro-competitive and as such violates the competitive enhancing flavor of the Staggers Rail Act.

The merger as proposed by DOT will lead to reduced competition and is inconsistent with the needs of the shipping community and the general public. Its anticompetitive nature cannot be nullified by the simple sale of a finite number of traffic corridors to smalller, less powerful railroads that can be effectively shut off from active competition with the merged railroad.

MARKET POWER AND TRAFFIC DIVERSION

Beyond a doubt all railroad mergers have resulted in significant efficiency improvement. Characteristically these efficiencies are not passed on to the shipper in the form of reduced rates but rather absorbed by the railroads in the form of increased profits.

What the shipper does see, however, with each merger is the immediate exercise of expanded market power. The most evident opportunity for the exercise of its power is through diversion of traffic, by closing gateways, to enhance revenue.

In the specific case of the proposed merger of Conrail and Norfolk Southern, one railroad will have a controlling influence over the five main gateways (New Orleans, Memphis, St. Louis, Kansas City and Chicago) between the Gulf Coast and West with the Northeast. Granted, this situation is partly in the hands of Conrail today, but its management has exercised this power judiciously and has cooperated with the shipping community to maintain competitive rates.

The market power available to the merged railroad far exceeds that currently in the hands of each of the independent railroads. The market power available to the merged railroad can have major consequences for the petrochemical, pulp, paper and mineral industries that have a heavy flow of goods in and out of the Gulf Coast, West and Northeast.

MANAGEMENT CONTINUITY

The current Conrail management team has very effectively transformed Conrail into a successful railroad. It has achieved substantial financial success while providing greatly improved service at competitive rates. It has achieved this by the aggressive pursuit of commercial opportunities made available under the Staggers Rail Act. It has been responsive to the needs of the shipping community and innovative in its marketing programs. At the same time it has invested in new equipment, improved its maintenance and consolidated or eliminated inefficient and redundant facilities.

Although the sale to Norfolk Southern can be characterized as a merger, it is not a merger worked out mutually between two consenting railroads. In this sense it has some of the characteristics of an unfriendly takeover. Conrail management will be merged into Norfolk Southern management under terms dictated by Norfolk Southern. The consequences of this will be a loss of the integrity of the very effective Conrail management team and a loss in responsiveness to Conrail's shippers needs.

LOCAL FINANCIAL IMPACT

Inevitably, the efficiencies to be gained from a railroad merger involve the merging of administrative and sales staffs. The elimination or transfer of over 7000 employees from Conrail's Delaware Valley operations has to be viewed as a very real possibility despite all assurances to the contrary. The direct tax loss in Philadelphia alone could exceed $8 million per year, in addition to the potential loss of employment of thousands of people. It is these same employees that have worked at lower than industry wages for several years to help nurse Conrail back to life, and these are the same communities and cities that have cooperated in the shedding of inefficient Conrail operations and replacement of these operations with other means of service.

LONG TERM PROSPECT

Much has been said about the long term prospects for Conrail and rail service in the Northeast. The premise that the Northeast cannot support three railroads in the long term is a weak one. There certainly is limited growth potential for rail traffic in that part of the country and more realistically the prospects of a slow decline. In a regulated environment Conrail's response to declining business would be limited. Under the provisions of Staggers it can respond quickly, creatively, and intelligently to changing market needs and a changing economic climate. The premise that the merger with Norfolk Southern is the only means to insure continued rail service in the Northeast is not justified.

THE PREFERRED SOLUTION

It's important that Conrail be maintained as a complete and discreet railroad. No doubt, it has developed into a profitable railroad with significant governmental assistance. It has also developed into a profitable railroad through the hard work and sacrifice of its employees, the patience and cooperation of its shippers and through aggressive and innovative management and marketing. Under the freedom provided by the Staggers Rail Act, Conrail management has developed a responsiveness to shipper's needs and changing economic conditions that will insure its viability in the future. There is no need to protect this by merging with the Norfolk Southern.

There are many alternatives to the merger of Conrail with Norfolk Southern. One of those options is to return Conrail to the public sector by means of a controlled public offering. This option was rejected prematurely by DOT in favor of an outright sale to a single bidder.

The sale to another major eastern railroad has never been a desirable alternative for the shipping community. With the emergence of Norfolk Southern as DOT's choice, public sale of Conrail represents a clearly superior option that will maintain the identity and substance of Conrail and the continuity of the Conrail management team. A public sale will maintain the current level of competition, rather than reduce it, and not disrupt the shipping community in any way through the divestiture and closing of rail corridors, and rail facilities.

We all agree that Conrail should be returned to the private sector in a timely fashion. But, the proposal recommended by DOT is not in the long term interests of the shipping community and should be rejected. A careful and thoughtful process to develop the best method of sale is in everyone's interest and should take precedent over a hasty and ill conceived sale.

We applaud your efforts to thoroughly review the impact of the Conrail sale on the shipping community. We also urge you to consider our position before taking legislative steps to effect the sale. We also thank you for the opportunity to make our views known to yourselves and the general public.

The CHAIRMAN. Thank you, sir.

Mr. Miller.

Mr. MILLER. It has been a long day, has it not? My statement is almost a summary, but in the interest of time, I shall try to summarize the summary, sir.

I represent the A.E. Staley Manufacturing Co., which is a large agribusiness company. Last year we shipped over 10,000 cars by Conrail, so we have an awfully high degree of interest in what happens to Conrail and to the area in which it serves.

One issue when we come down to it is of primary importance to us; that is, we must be assured of good railcar service in the area served by Conrail. We can talk about all the other factors we want to, but that is the one thing that has to be.

We hear an awful lot of self-serving comments about things that might be, of how service might be maintained, about competition, about financial viability; but when we come down to it, the only alternative that is being considered where there is no disagreement about the financial viability of the company, or the situation, or the ability of the resulting entity to serve the area, is the Norfolk Southern acquisition. And therefore, we feel we have to choose that as the best solution to the problem at hand.

One other problem does exist, and that is the problem of competition. Should the Norfolk Southern acquire Conrail, all of our plants will be located on the Norfolk Southern. Two of them will be in areas where there is no other rail service. We are in what this day and age is called a captive shipper.

We like competition. I love competition. It makes my job much, much easier. But I have found that in this new day and age that intermodal competition is not mandatory if we are to achieve the results that we feel we have to achieve.

What we have to have is a relationship between the shipper and the carrier that allows me as a shipper to get what I have to get and allows the carrier to make a profit on that transaction.

Now, we have got a long association with the Norfolk Southern and with Conrail, and we have found that the Norfolk Southern marketing sales organization recognizes our problems. We have had a lot of negotiations. They have been long and they have been hard, and in almost every case whether there has been competition or not, we have been able to achieve a result that has been satisfactory to us and we hope to the Norfolk Southern.

Therefore, we do not feel, at least as it relates to our company, that this lack of intermodal competition that we have heard so much about, this competition which I think is for my benefit, not the benefit of the people participating, is not a serious problem to us.

Therefore, in conclusion, we feel that the acquisition of Conrail by the Norfolk Southern is in the best interest of our company and its employees, of our customers, and of the public generally. We hope you concur.

[The statement follows:]

STATEMENT OF THE A.E. STALEY MANUFACTURING COMPANY

My name is Reeder C. Miller. I am Vice President of Corporate Transportation for the A.E. Staley Manufacturing Company. Staley, a wholly owned subsidiary of Staley Continental, Inc., with annual sales in excess of two billion dollars, is an international agribusiness company with corn processing plants in Illinois, Indiana, Pennsylvania, and Tennessee. We process in excess of 125,000,000 bushels of corn annually. Until recently we also had soybean processing plants in Illinois, Indiana, Missouri, and Ohio. In fiscal 1984 we shipped in excess of 10,000 cars by ConRail. Obviously we have a significant interest in what happens to this railroad and the area it serves.

In analyzing the various possibilities for the future of ConRail, we are concerned about the quality of service we will receive, the costs we will incur in shipping into or out of the area involved, and the impact the change will have on our customers and our operations. These things are of great concern to our company and must be taken into account as we consider the future of ConRail.

However, one issue is of paramount importance. We feel that, regardless of any other concerns, we must be assured of good railroad service in this area. We cannot afford to have a situation like that which existed when the area was served primarily by the Penn Central, or even in the early days of ConRail. While other factors may be important in our deliberations, this service assurance is an absolute must. And of all the alternatives which have been presented, the Norfolk Southern acquisition appears to be the only alternative which will assure this service.

The Norfolk Southern is already a major railroad in the United States. They are strong financially and over the years they have demonstrated their ability to "run a railroad." Their recent merger and the strong system that resulted from that merger is evidence of their ability to integrate railroad systems. Various financial experts appear to disagree about the financial aspects of the other alternatives. However, we hear no disagreement concerning either the financial viability or the ability to manage a railroad system of this magnitude about the Norfolk Southern. We cannot afford to gamble on this issue. We must choose the alternative which meets this requirement. Thus our choice is for the Norfolk Southern.

Having made this determination, the issue should be clear. However, other potential problems do need to be considered. The most important of these is the issue of competition. Should the Norfolk Southern acquire ConRail, all of our corn processing plants will be located on the Norfolk Southern. Two of these plants are in locations where there will be no other railroad service. Obviously we would like competition. But we do not feel that intra modal competition is mandatory for us to achieve the results we must achieve. What is needed is a relationship between shipper and carrier which allows the shipper to achieve his needs and also provides a return which is profitable for the carrier.

We have had a long association with the Norfolk Southern. Over the years we have found their marketing/sales organization recognizes the distribution needs of their shippers and have reacted to meet those needs. In almost every case, we have been able to meet the dual objectives of shipper needs and carrier profit, even in those situations where intra modal competition did not exist. Therefore, we do not feel, at least as it relates to our company, that the lack of intra modal competition would be a serious problem for us in this situation.

We have had an excellent relationship also with the people on ConRail. We sincerely hope that it will be possible for them to remain in the positions they now hold so that relationship can continue. However, if we have to sacrifice something, we feel it is better to have an economically viable railroad in place than it is to have a continuing relationship with good people who must struggle against insurmountable odds.

In conclusion we feel the acquisition of ConRail by the Norfolk Southern is the only solution which meets the long term needs of our company and its employees, of our customers, and of the public generally. We wholeheartedly recommend this acquisition and hope you will concur.

The CHAIRMAN. Thank you very much, Mr. Miller.

Mr. Casey.

Mr. CASEY. Thank you, Mr. Chairman.

My company is a federated regional agricultural cooperative operating primarily within the State of Ohio. We are heavily involved in the grain, feed, petroleum, and farm supply businesses, fertilizer business also.

Needless to say, transportation is a vital component of our business, the business of our 44 cooperative associations who are our owners and our members, and the businesses indirectly of some 60,000 or so farmers who own the local associations and are our final customers.

Currently, 35 of our business facilities are served by Conrail, 30 by the Norfolk Southern, 25 by the CSX, 5 by the DT&I and 1 by a short line railroad. Our system shipments will generate in excess of $8 million a year in revenue for the railroads. We are vitally interested in all factors that may affect rail service, and returning Conrail to private ownership certainly is one of those factors.

We think we have been consistent from the beginning. We have stated that we believe that the primary consideration in determining the final disposition of Conrail should be the optimization of the return to the major stakeholders. And we identify those as the government entities involved, Federal, State, and local governments, the employees of Conrail and the users of the Conrail system.

Now, with these diverse stakeholders, it is obvious that compromises are going to be required if the aggregate return to the stakeholders is to be optimized. There are both short-term and long-term considerations.

The short-term considerations include the immediate return to the Federal Government and others with either financial or career investments in Conrail. It appears these considerations are addressed in the agreement negotiated by the Department of Transportation with the Norfolk Southern Railroad.

The longer term considerations revolve around the long-term viability of the resulting entity. This is of paramount importance to users, to government taxing entities, and I believe even to competing transportation companies.

The long-term viability question is, in our opinion, the strongest argument in favor of the sale to the Norfolk Southern Railroad. The Eastern United States today is served by three major railroads. Not too many years ago these three were at least six, and before that even more. The trends in the economics of the industry and in the demand for service that resulted in only three railroads continue.

The combining of Conrail and the Norfolk Southern would result in the Eastern United States being served by two strong major railroads. Each would have the financial, physical, and management resources, as well as the customer base, to adapt to the changing environmental conditions. Strong, rather than weakened railroads, are in the interest of all of the stakeholders.

We firmly believe the sale of Conrail to the Norfolk Southern will ensure continued viable rail service to the users in the Eastern United States.

Thank you.

The **Chairman**. Mr. Casey, thank you very much.

Mr. Gordon.

Mr. **Gordon**. Thank you, Mr. Chairman.

My name is Bruce Gordon. I am the director of transportation for B.F. Goodrich Co.'s Chemical Group with headquarters in Cleveland.

Goodrich is a diversified manufacturer of plastics, specialty chemicals, tires, industrial rubber goods and products for the construction, mining, and aerospace industries. With manufacturing facilities in 17 States throughout the country, we have a natural reliance upon an effective rail transportation network. Primarily in our chemical businesses we have substantial investments in specialized rail equipment to transport our bulk raw materials and finished products. Our current rail car fleet of over 2,000 cars has a net capital replacement value of over $100 million.

Consolidated Rail Corporation serves our plants in Kentucky, New Jersey, Ohio, and Pennsylvania. In 1984 Goodrich paid freight charges to Conrail in excess of $8½ million. We consider Conrail to be a key supplier of transportation services, and thus are vitally interested in the Government's proposed sale of the railroad.

The Department of Transportation has arrived at this point, offering Conrail for sale as an entity, because of the fine efforts of the Conrail management team. In particular, Messrs. Crane, Hagen, and Hasselman, should be congratulated for the fine performance of Conrail. An obvious testimony to this commendable job is the numerous bids which were received by the Department of Transportation to purchase the line.

I would like to share with you our criteria that we used to analyze the finalists' offers. The primary concern was the need for an ultimate acquirer to have exhibited successful rail management expertise. This would provide a continuity of service to an area of the country which has been buffeted by the collapse of several predecessor railroads, major shifts in its industrial base, and deregulation of the surface transportation industry.

The logical extension of this concern was a demonstrable commitment to maintain rail service on a long-term basis; thus, a strong financial base was considered to be essential to sustain the acquiring entity through the next phases of the economic cycle.

We are deeply concerned by the competitive impact on the rail industry which the Conrail sale would have. This could take the form of further gateway eliminations or shifts in the balance of ownership among rail terminal operators, or a reduction from two carriers to one in certain key markets.

Our conclusion with respect to the final bidders is that the Norfolk Southern Corp. most closely meets our requirements. Obviously, Norfolk Southern's major line of business, railroading, gives it the expertise in running the acquired company.

Norfolk Southern now serves major Goodrich facilities in Kentucky, Indiana, and Ohio, and it has proved its ability to provide safe, efficient rail transportation services.

Our second concern, financial stability, is also felt to be met most efficiently by the Norfolk Southern acquisition. The Northeastern United States is undergoing significant change in its industrial base. The next downturn in the economic cycle may mean further erosion of its traditional industrial base. The assets of the Norfolk Southern and its financial performance provide a significant safety net for this eventuality.

Our final barometer, competitive impact, has not fully been satisfied. Shippers and carriers fear that upon acquiring Conrail, Norfolk Southern will be able to exercise market power to the detriment of competition. B.F. Goodrich sympathizes with these concerns, but feels that the conditions outlined in the Justice Department's letter to Secretary Dole generally will prevent this.

The key to meeting the Department of Justice requirement places the emphasis on the provision of long-term competition in the affected corridors, those that are outlined for divestiture. Careful study must be given to the staying power of the proposed acquiring partners in those corridors.

Merger efficiencies oftentimes place reliance on single line rail service as being more efficient. Joint line routes are and certainly have been exhibited to be more efficient in certain cases. At the same time, Conrail has proven its profit-generating capability with major gateways at Washington, DC, Cincinnati, Ohio, East St. Louis, IL, and Chicago.

A moratorium on gateway closures may be an essential sale condition. However, a strong safeguard against improper exercise of market power by the Norfolk Southern may arise from two proceedings pending at the ICC.

The first is Docket No. 39176, the Chlorine Institute's complaint proceeding against the post-1980 railroad cancellations of joint rates, routes and reciprocal switching arrangements. The second is Ex Parte 456, which is the ICC's general inquiry into the administration of the Staggers Act.

In both these proceedings, the Chlorine Institute—of which B.F. Goodrich is a member—has proposed that the ICC utilize antitrust principles when determining the lawfulness of railroad conduct affecting competition.

If, in fact, the ICC opts for an analysis based on antitrust principles, the agency will be able to ensure that vigorous competition will remain in the railroad industry. Using such principles the Commission will be able to prescribe competitive joint rates, routes and reciprocal switching where necessary to prevent a substantial reduction in competition. Thus, even a large carrier like the post Conrail-Norfolk Southern will be unable to exclude potential rail carriers from serving shippers on its lines if such exclusion amounts to an exercise of market power in contravention of antitrust principles. Those are basically the principles that all of us in business operate under today.

In conclusion, the Norfolk Southern acquisition of Conrail on the whole will provide a balance between the competitive interests of the industry and individual profit motives. Norfolk Southern has earned our trust through their actions. We consider them to be an excellent supplier of transportation services and deserving of the opportunity to expand their scope of operations.

Thank you.

[The statement follows:]

STATEMENT OF THE B.F. GOODRICH CO.

My name is Bruce T. Gordon. I am the Director of Transportation for the B.F. Goodrich Company (Chemical Group) with headquarters in Cleveland, Ohio. I have been involved in the industrial transportation field for over 12 years. I have been admitted to the practice of Law before the Supreme Court of Ohio and am a registered Interstate Commerce Commission Practitioner.

The B.F. Goodrich Company is a diversified manufacturer of plastics, specialty chemicals, tires, industrial rubber goods and products for the construction, mining, aerospace and defense industries.

Goodrich has manufacturing facilities in Alabama, California, Georgia, Indiana, Illinois, Kentucky, Louisiana, Maryland, North Carolina, New Jersey, Ohio, Oklahoma, Pennsylvania, South Carolina, Tennessee, Texas and West Virginia. With this diversity of manufacturing operations, we have a natural reliance upon effective rail transportation.

Primarily on our chemical businesses, we have made substantial investments in specialized rail equipment to transport our bulk raw materials and finished products. Our current fleet of over 2,000 rail cars has a capital replacement value of over $100,000,000.

Consolidated Rail Corporation serves our plants in Kentucky, New Jersey, Ohio and Pennsylvania. In 1984 Goodrich paid freight charges to Conrail in excess of $8,500,000. We consider Conrail to be a key supplier of transportation services and thus are vitally interested in the Government's proposed sale of this railroad.

We are in complete agreement with Government's efforts to return this important rail system to private sector control. We do recognize that agreeing on what must be done is far easier than agreeing on how it must be done.

The Department of Transportation has arrived at this point, offering Conrail for sale as an entity, because of the fine efforts of the Conrail management team. In particular Messrs. Crane, Hagen and Hasselman should be applauded for the fine performance of Conrail. An obvious testimony to this commendable job is the large number of bids received by the Department of Transportation to acquire the line.

The B.F. Goodrich Company considers the sale of Conrail to be one of the most significant transportation events of this decade. Following the enactment of the Staggers Rail Act of 1980, the creation of the mega-carriers through merger or acquisition has significantly changed the make-up of the United States railroads. The sale of Conrail will complete this evolution. Branch line abandonments and cancellation of joint line rates have also had an impact on shipper—carrier relations, tending to limit access to the rail system or eliminating intra-modal rail competition.

I would like to share with you the criteria we used to analyze the "finalist's" offers and the conclusion we reached.

A primary concern was the need for the ultimate acquirer to have exhibited successful rail management expertise. This would provide a continuity of service to an area of the country which had been buffeted by the collapse of the predecessor railroads, major shifts of its industrial base and deregulation of the surface transportation industry.

A logical extension of this concern was a demonstrable commitment to maintain rail service on a long term basis. Thus a strong financial base was considered essential to sustain the acquiring entity through the next phase of the economic cycle.

We are deeply concerned by the competitive impact on the rail industry which the sale of Conrail would have. This can take the form of further gateway eliminations or shifts in the balance of ownership among rail terminal operators or reduction from two carriers to one in certain key markets.

Our conclusion with respect to the final bidders is that Norfolk Southern Corporation most closely meets our requirements.

Obviously Norfolk Southern's major line of business, railroading, gives it the expertise in running the acquired company. Norfolk Southern now serves major Goodrich facilities in Kentucky, Indiana, and Ohio. It has proven its ability to provide safe, efficient rail transportation services.

Our second concern, financial stability, is also felt to be met most efficiently by a Norfolk Southern acquisition. The northeastern United States is undergoing significant change in its industrial base. The next downturn in the economic cycle may mean further erosion of its traditional industrial base. The assets of the Norfolk Southern and its financial performance provide a significant safety net for this eventuality.

Our final barometer, competitive impact, has not been fully satisfied. Shippers and carriers fear that upon acquiring Conrail, Norfolk Southern will be able to exercise market power to the detriment of competition. B.F. Goodrich sympathizes with these concerns, but feels that the conditions outlined in the Justice Department's letter to Secretary Dole generally will prevent this.

The key to meeting the Department of Justice requirements places the emphasis on the provision of long term competition in the effected corridors (those lines outlined for divestiture). Careful study must be given to the "staying power" of the proposed acquiring party.

Merger efficiencies oftentimes place reliance upon single line rail service as being more efficient. Joint line routes are more efficient in certain cases. Conrail has proven its profit generating capability with major gateway at Washington, D.C.: Cincinnati, Ohio; East St. Louis, Illinois; and Chicago, Illinois. A moratorium on gateway closures may be an essential sale condition. However, a strong safeguard against improper exercise of market power by Norfolk Southern may arise from two proceedings pending at the ICC. The first is Docket No. 39176, the Chlorine Institute's complaint against post-1980 railroad cancellations of joint rates, joint routes and reciprocal switching arrangements. The second is Ex Parte 456, the ICC's general inquiry into the administration of the Stagger's Act. In both these proceedings, the Chlorine Institute (of which B.F. Goodrich is a member) has proposed that the ICC utilize antitrust principles when determining the lawfulness of railroad conduct effecting competition. If, in fact, the ICC opts for an analysis based on antitrust principles, the agency will be able to ensure that vigorous competition will remain in the railroad industry. Using such principles, the Commission will be able to prescribe competitive joint rates, routes and reciprocal switching where necessary to remedy or prevent a substantial reduction in competition. Thus, even a large carrier, like the post-Conrail Norfolk Southern, will be unable to exclude potential rail competitors from serving shippers on its lines if such exclusion amounts to an exercise of market power in contravention of antitrust principles.

In conclusion, Norfolk Southern acquisition of Conrail, on the whole will provide a balance between the competitive interest of the industry and individual profit motives. Norfolk Southern has earned our trust through their actions and we consider them to be an excellent supplier of transportation services and deserving of the opportunity to expand the scope of their operation.

The **Chairman**. Thank you, Mr. Gordon.

Mr. Wilkins.

Mr. **Wilkins**. Thank you, Mr. Chairman.

My name is Charles Wilkins. I am manager of transportation analysis and procurement for Ford Motor Co.

Ford's manufacturing operations in the United States and Canada consist today of over 60 assembly plants and manufacturing locations, most of which are in the Northeastern United States. The current projections are that we will spend about $2 billion on transportation services in 1985, and of this, about one-half for rail transportation. Of the billion we will spend with the railroad industry, we will spend nearly $300 million with Norfolk Southern and Conrail.

Ford Motor Co. was pleased with Secretary Dole's recent announcement that the Department of Transportation had recommended the Norfolk Southern's proposal. Ford has been on record with the Department of Transportation since August of 1984 as favoring the Norfolk Southern proposal over all others. Ford's primary concern in this matter is with efficient rail service over the long term. It was our conclusion that of all of the bidders, only the Norfolk Southern could provide a real long-term commitment to rail service.

We have been advised that studies initiated by both Norfolk Southern and CSX made a convincing case that there is a declining market for rail service, particularly in the Northeastern United States, and that eventually there will not be enough traffic to support three major rail systems. Therefore, the acquisition of Conrail by Norfolk Southern seemed to make a great deal of sense.

Another factor which we considered in reaching our decision was the impact of our just-in-time manufacturing systems on the railroad industry, and in particular on Conrail. Just-in-time manufacturing systems strengthen the competitive position of the trucking industry due to their reliance on frequent shipments and the absolute need for accurate and timely movement.

Conrail already faces more direct competition from the trucking industry than any other railroad with whom Ford does business, and our just-in-time manufacturing programs will strengthen these competitive pressures.

On the other hand, we believe that a combined Norfolk Southern-Conrail can provide substantial competition to the trucking industry as it would create single-line service on many Ford material movements.

It is true that Norfolk Southern and Conrail in combination will serve more than 30 of our manufacturing and assembly locations, which does raise a concern about railroad competition. However, we note the Norfolk Southern has agreed to reestablish routings with smaller regional carriers such as Guilford, Grand Trunk, and the Pittsburgh & Lake Erie. In addition, the conditions placed on the proposed merger by the Department of Justice will do a great deal to restore and maintain competitive rail service in important corridors.

Furthermore, in Ford's view, Norfolk Southern has not initiated route or gateway closings, and their policies regarding such anticompetitive practices are not likely to change in the future, in our view.

In summary, Ford believes that the Norfolk Southern proposal best assures competitive rail service in the northeast for several reasons.

As stated previously, we do not think there is enough business for three major systems. Second, truck competition will continue to increase. And third, if Conrail is to return permanently to the private sector, its purchaser must have the financial resources, experience, and interterritorial reach to sustain these challenges and to diminish Conrail's dependence on the fluctuating economy of the Northeast.

Ford believes Norfolk Southern is such a purchaser. Norfolk Southern appears committed to maintaining continued Conrail rail service and is willing to put its resources behind this goal.

To this end, Norfolk Southern has stated publicly that it will operate Conrail as a division of the holding company, as a companion to the Southern Railroad and the Norfolk & Western, with appropriate coordination of marketing and operating activities.

Ford has had an extensive business relationship with the Norfolk Southern. We consider the Norfolk Southern to be a responsive service- and market-oriented carrier which has earned our business. Ford firmly believes Norfolk Southern's record of profitability and their commitment to the transportation industry provides the best assurance that its acquisition of Conrail will serve the public interest.

Thank you.

The CHAIRMAN. Gentlemen, thank you very much.

We have heard in the last 2 days a variety of opinions as to what we should do. I think that the common threads running through all opinions are: First, a general consensus, maybe a unanimous consensus, that Conrail should be sold. That the Government should not continue to be in the freight rail business; second, a general consensus that we should get on with it, that we should not just worry the thing to death and keep the ball in play forever; and third, a general consensus that we need to balance two interests. One interest is that whoever is going to be operating Conrail be sound enough financially so that that operation will be ably performed, so that we are not going to be in a position 2, or 3, or 4, or 5 years from now wondering what happened to that outfit that we sold Conrail to and so that we will not be back in the business all over again of trying to figure out what the Government is going to do with a railroad.

So the whole question of soundness, financial stability, viability, as some of you have said, is one of the things that we should put into this consideration.

The second issue is one that is particularly important to each one of you, to all shippers, and that is the whole question of competition. Nobody wants to be a captive shipper if it can be avoided.

I do not want in this hearing and certainly not at 10 minutes until 7 in the evening to open up the whole issue of the Staggers Act, and I know you all have opinions of the Staggers Act, and how the ICC implements the Staggers Act, and whether Congress should be doing anything about ICC implementation of the Staggers Act. I have opinions about that, and I am going to reserve them for another day. But I would like to ask you this general question.

From your own standpoint in looking at the question of competition in the railroad industry, what seems the most important to you—the Staggers Act question and how the ICC interprets and implements the Staggers Act, or who ends up owning Conrail?

Mr. CASEY. Mr. Chairman, I will take the first response and then pass the microphone on.

I think really the most serious question is the Staggers Act, how it is implemented and how the ICC operates under it.

The CHAIRMAN. Thank you, sir.

Mr. MILLER. I would have to imagine that your question presupposes if we choose the Staggers Act it would mean some kind of activity by the Congress. On that basis I would choose Conrail, because in my opinion the Staggers Act is the greatest thing since sliced bread and I do not want to see anything happen to it.

On the other hand, I think that the disposition of Conrail is very important to a very significant segment of our country and should be disposed of very quickly.

Mr. JACOBSON. I would like to say also that I think the Staggers Act and the freedoms offered to the railroads and the shipping community under the Staggers Act are far more important than perhaps who owns Conrail. And in actual fact, it is those freedoms and the flexibility under Staggers which is going to enable Conrail or has enabled Conrail to recover and would enable Conrail to survive into the future, or any buyer of Conrail.

So as an either/or, it is rather an unfair question, but that is my opinion.

The CHAIRMAN. Mr. Wilkins.

Mr. WILKINS. I think I would have to say the disposition of Conrail is the more important of those two issues for the next year. I think the situation we have, the issues on Staggers are something we can live with for a while if we have to. And as you said a moment ago, I do not think we ought to let the Conrail matter drag on forever.

The CHAIRMAN. Mr. Gordon.

Mr. GORDON. In all honesty, I think the sale of Conrail is the most important issue in transportation for 1985. The activities before the Commission, to which I referred earlier, along with the AAR and several major shippers groups in negotiating toward some competitive access conclusions may well blunt the need to do any tinkering with Staggers. It is a document that is working fairly well, and I would concentrate our efforts on Conrail.

The CHAIRMAN. I have never seen a group of shippers take such a warm position toward the Staggers Act before.

Mr. **Miller**. That is our fault, Senator, because we have not been speaking up, but we will now.

The **Chairman**. Gentlemen, thank you very much for your testimony, which is very helpful, and also for your patience.

That concludes the hearing.

[Whereupon, at 6:55 p.m., the hearing was adjourned.]

SALE OF CONRAIL

THURSDAY, APRIL 4, 1985

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The committee met, pursuant to notice, at 1:30 p.m. in room SR-253, Russell Senate Office Building, Hon. John C. Danforth (chairman of the committee) presiding.

The CHAIRMAN. Senator Pressler has a statement which he would like to make.

OPENING STATEMENT BY SENATOR PRESSLER

Senator PRESSLER. Well, first of all I want to thank Chairman Danforth for holding this hearing today. And I also wish to say that I shall oppose the sale in its present form unless there are changes made.

Also, today I think it is very significant, because our first witness as I understand it, from the Chicago & North Western, will announce their opposition to the present plan. But I should emphasize that when I asked for this hearing along with Senator Exon that the Chicago & North Western was not a part of that request. They have since made their own decision, and I called for this hearing to look into some of the impact on Midwestern railroads in the context of this sale.

The sale of Conrail is one of the most important transportation issues facing us today and it merits careful consideration. This committee has already held 2 days of hearings. I stated that my main concern with this entire transaction was its impact on regional carriers in the West and Midwest. This is still my main concern. It is the purpose of asking for this hearing today.

I have a number of questions that remain unanswered. How they are addressed today and in the weeks ahead and what changes we can make will determine my vote on and reaction to this proposal.

Before focusing on the specifics of my regional concern, I might just take a minute here to respond to some of the press reports and opposition statements about how this committee is allegedly steamrollering the sale of Conrail. I resent that statement and I resent the statements made by some that our request for this hearing today is in any way connected with the efforts of some obstructionists to stop the sale of Conrail to Norfolk Southern at any cost.

To be sure, there are both obstructionists and steamrollers on either side of this issue. I am certainly not sympathetic to either effort and I do not believe any member of this committee is.

I do have legitimate concerns about the spillover effect the proposed sale may have on Midwestern regional carriers and the entire process by which these concerns were supposedly addressed. I have expressed them to the chairman and he very kindly agreed to hold these hearings today.

I want to make it clear that the timetable must go forward, but I do want to hear what some of our carriers have to say. I am particularly concerned about the potential diversion of traffic from the Chicago to the Kansas City gateway and its effect on regional carriers in the Midwest.

As I understand it, a merged Norfolk Southern-Conrail would exercise heavy influence over the flow of east-west traffic through its market control over the termination points in the Northeast. The Department of Justice does not focus on traffic diversion because it says the estimates are too inconclusive, but the problem still needs to be addressed.

While I realize the traffic diversion issue has been addressed to a certain extent through the divestiture plan, I still have serious reservations at the adequacy of the proposed divestiture and the procedure by which it came about. Basically, I am not convinced that the confines of the designated corridor outlined in the Department of Justice letter adequately focus on the potential spillover problems in the Midwest.

Specifically, I am referring to the traffic diversion problem which could ultimately result in serious anticompetitive problems. While it is fairly clear that shipping costs initially may be reduced in order to divert traffic from the Chicago to the Kansas City gateway, I am concerned about its impact several years down the road when it may be too late to redirect the traffic, when any effective competition is eliminated.

So my primary concern in this area is that the concerns of the Midwest or Midwestern carriers were not adequately addressed in this whole divestiture process. I am all for a strong transportation system in the Northeast, but certainly not at the expense of the Midwest.

Turning toward the procedural concerns I have about the divestiture issues, I think it is extremely important that we look at the process by which this divestiture proposal came about. This is key to the whole anticompetitive argument that is made on this proposal.

The Department of Justice letter plainly states that without appropriate divestiture the proposed merger would violate both the Clayton Act and the Interstate Commerce Act and have a significant adverse effect on competition. This is based mainly on the study of the physical lines, without a great deal of attention given to the traffic diversion issue.

So it seems to me that, since effective divestiture is the only real safeguard against monopolizing the entire Northeastern United States, it should be done very carefully and objectively. Yet here we are allowing what might soon become the biggest transportation conglomerate in the United States to choose not only which of its lines it will divest, but also to whom it will divest the lines.

In effect, it gets to choose its competitors and which of its tracks it will allow the so-called competitor to use. To be sure, the Department has set some general guidelines to be followed in the divestiture. But the bottom line is that Norfolk Southern gets to do the choosing. And I might add, it seems they have done a pretty good job for themselves.

To me this seems extremely dangerous. I would be much more comfortable if an independent review of this issue was done by the ICC or the Department of Justice and have them in some type of competitive bidding process selecting the alternative carriers and track to be divested. We should have set up some type of process analogous to the ICC procedures in every other merger case where divestiture is required.

The reason I raise this issue ties directly to my concern about the effect of this merger on the Midwest. The divestiture has to protect against not only the traffic monopoly of the Northeast, but also against the monopolistic control over the destination markets. The Norfolk Southern's control over the access to the Northeast as a destination is the key to what I call the Midwest problem in this merger.

The Northeast is a net consumer. Control over the destination points to a net consumer is very important, and this is a problem somewhat unique to the Northeast. The key to alleviating this problem, short of a stand-alone Conrail, is to be very certain that the divestiture is done in an objective manner, with due consideration given to the Midwest problem.

I cannot see how this is possible, given Norfolk Southern's principal participation in the divestiture process and its vested interest in making sure the divestiture is not as competitive as possible. It would seem to me much more prudent to require an independent selection process for both the acquirer and the lines to be acquired, as in the case of the other merger-related mandated divestitures.

Even if within the guidelines set forth by the Department of Justice, Norfolk Southern's selection of the Guilford and of the Pennsylvania and Lake Erie railroads seem indicative of the concerns I raise, do not misunderstand. I do not blame Norfolk Southern for wanting a less viable competitor. Indeed, the management would probably be violating its fiduciary duty to its stockholders if they chose anyone else.

But the fact remains that they did the selecting, and it is no accident that a more viable competitor, such as the Grand Trunk, was not selected, or that no public notice or bid solicitation was sent out.

So my whole point on this issue is that if we do not have a stand-alone Conrail through a public offering or competitive bidding, we should at the very least make sure that the so-called competitive alternative is truly competitive, or even maybe some type of gateway protection amendment could alleviate the problem. But it is impossible to charge Norfolk Southern with the responsibility to look out for both its competitors and stockholders.

Finally and in conclusion, I will touch on one parochial point and then end this statement so we can get on with the hearing. I am perpetually concerned with railroad abandonments and fighting with railroads in South Dakota to keep them from abandoning South Dakota lines they consider marginal or even losing money.

The very existence of these lines is contingent upon the viability of their main lines, such as the case with Chicago & North Western, which we will hear about later. My concern is that these small branch lines in South Dakota, Nebraska, and other States will ultimately feel the blow if there is substantial traffic diversion from the Midwestern main lines.

My point is that, as I see it, this Conrail-Norfolk Southern merger could have a much more far-reaching ripple effect than it appears to at first glance, and we need to take a much closer look at that aspect of it as well.

With that, Mr. Chairman, I close my formal remarks by again thanking you for holding this hearing here today. I commend you for your work on this important issue and I look forward to working with you as we go forward.

The CHAIRMAN. Fine, Senator Pressler.

I think that the only similarity between the Congress of the United States and a steamroller is the speed with which both move.

Senator Exon, do you have any comments?

OPENING STATEMENT BY SENATOR EXON

Senator EXON. Mr. Chairman, thank you very much. Mr. Chairman, I want to thank you for scheduling this additional hearing on the sale of Conrail to the Norfolk Southern Railroad.

When Senator Pressler and I wrote you requesting this hearing, we did so out of concern over the impact of the sale of Conrail on rail transportation in the Midwest. On the surface, some ask why two Senators from the Midwest, whose States do not appear to be directly impacted by the proposed Conrail sale, would be interested enough to ask the Commerce Committee to schedule an additional hearing. Good question.

The answer to this question is really, though, quite simple. Rail transportation across this Nation is transcontinental, one railroad company interconnecting with another in order that goods can be shipped without interruptions. Conrail is an integral part of this system, as is the Norfolk Southern, and it is important to look at the impact that this proposed sale will have if allowed by Congress to take place and what it will do to our overall rail system.

Today I hope that the hearing will focus on what, if any, traffic diversions will occur among Midwest railroads as a result of this proposed sale. Furthermore, I trust we will be able to ascertain the extent to which competitive access to the Midwest will be retained and the degree to which the proposed divestiture from the Norfolk Southern to Guilford and the Pittsburgh & Lake Erie will ensure the continuation—I emphasize, continuation—of competitive eastern connections to the Midwest.

These issues are of great importance to those of us from the Midwest region, and we look forward to the testimony that addresses them.

Finally, Mr. Chairman, I have been asked by Mr. Martin G. Colladay, vice president of ConAgra, Inc., of Omaha, NE, to insert a copy of his recent letter to me expressing ConAgra's opposition to the proposed sale of Conrail to Norfolk Southern.

Again, Mr. Chairman, I wish to thank you for your cooperation and that of my friend and colleague from South Dakota, and I would request that the letter that I referred to from Mr. Colladay be inserted in the record.

The CHAIRMAN. Fine, Senator Exon. The letter will be inserted in the record.

Senator Ford, do you have any comments?

Senator FORD. You will hear from me later, but I have a statement Senator Inouye would like to have included in the record.

[The statement follows:]

OPENING STATEMENT BY SENATOR INOUYE

Mr. Chairman, though I have no direct state interest in the sale of Conrail, I share my colleagues' concern that this matter be handled in a manner that is mutually beneficial to the shippers, the railroads, and the federal government. I am pleased that the Committee has scheduled this third day of hearings on the sale of Conrail to assure that all the relevant issues and concerns are considered before action is taken.

I believe that most of us agree that the country would be best served by the sale of Conrail to the private sector. The details of such a sale must be carefully scrutinized, however, to assure that in our efforts to solve problems we do not create even greater problems. I know that the Chairman and Senator Hollings support the sale of Conrail to Norfolk Southern as laid out by Secretary Dole, and have introduced legislation to carry this out. I would tend to support this position, but I feel that all concerns of other Committee members be adequately addressed before we act on this legislation. I look forward to working with my colleagues in this regard.

The CHAIRMAN. The first witness is Mr. Jerome Conlon, senior vice president, governmental affairs and corporate analysis, Chicago & North Western Transportation Co.

STATEMENT OF JEROME W. CONLON, SENIOR VICE PRESIDENT FOR GOVERNMENT AFFAIRS AND CORPORATE ANALYSIS, CHICAGO & NORTH WESTERN TRANSPORTATION CO.

Mr. CONLON. Mr. Chairman, Senators.

Thank you for this opportunity to be with you today to express the Chicago & North Western's concerns about the Conrail-Norfolk Southern merger. My name is Jerome Conlon. We took half of the hearing stating what my title is, so I will just say that I am senior vice president.

The Chicago & North Western is the eighth largest railroad in the United States. We operate 7,500 miles of railroad in the Midwest. In 1972 we became an employee-owned railroad and today our employees and former employees continue to constitute the largest group of shareholders of stock. We currently employ 11,000 people.

Not unlike the Northeast, the Midwest has undergone a prolonged and often painful rationalization of its rail transportation system. The C&NW is an active participant in this rationalization process. Through cost-cutting, which included extensive abandonments, as Senator Pressler noted, we put our own house in order and avoided bankruptcy.

At the same time, we substantially rebuilt our plant, introduced innovative marketing, and built a new line of railroad into the Wyoming coalfields. During the last 2 years, we have committed approximately $150 million for the purchase and rehabilitation of the

North-South mainline and branchlines acquired from the Rock Island.

We are proud of the fact that we have emerged as one of the strongest links in the Midwest rail system, and we believe that that strength is a major asset to our region of the country. Having gone through the rationalization process ourselves, we have a keen appreciation for all that Conrail has accomplished.

While we wholeheartedly support the principle of transferring Conrail to the private sector, we oppose the Norfolk Southern-Conrail merger as currently proposed. It could result in significant harm to shippers, consumers, employees, our railroad, and the upper Midwest economy in general.

This committee has previously heard from the other major carrier in our region, the Illinois Central Gulf, which has testified to the adverse impact that this merger would have on their railroad. The North Western would be similarly harmed, and we support the statements of the Illinois Central Gulf.

The C&NW interchanges more than 200,000 carloads per year with Conrail at the Chicago gateway. The majority of this traffic is transcontinental in nature, moving across our East-West mainline from Fremont, NE, to Chicago. Our diversion studies estimated that the long haul advantages of the NS-Conrail combined system could affect almost 50 percent of the traffic that moves through the Chicago gateway by diverting it to the Kansas City gateway.

To help put in perspective the effect of a Norfolk Southern-Conrail merger, it is important to know that our East-West mainline which handles this divertible traffic is only 7 percent of our system mileage, yet handles 47 percent of our gross ton-miles. The Norfolk Southern-Conrail merger therefore strikes at the very core of our system.

Thus, we think that diversions have been overlooked, as have the ripple effects of these diversions on the economy of the Midwest. We support the goals set forth by the Department of Transportation in transferring Conrail to the private sector. However, we feel that relevant factors have not been fully considered.

First, we are concerned that the usual transportation issues have not been thoroughly considered. Although the ramifications of this merger are greater than those of any other transportation merger that has ever preceded it, the present procedure falls short of that which has accompanied other railroad mergers, as I so poignantly know from my recent Milwaukee experience.

Some of these concerns are:

One, impact on regional railroads;

Two, the limited number of markets studied as to what the competitive effect would be;

Three, the diversions have not been fully examined.

This is not a private merger. It is the final step of a 10-year process, planned and financed by the Federal Government. It will, if Norfolk Southern is successful, result in the largest railroad in the United States. The uniqueness and magnitude of the sale warrants more scrutiny, not less, than a private merger. Yet that is not what is happening today.

Second, we believe the Justice Department has not fully studied the impact this merger will have on connecting regional railroads, nor has it fully analyzed the effect of existing competition between carriers. Its analysis did not consider the realities of transportation.

As I indicated, this is a critical issue to those railroads in the Midwest which are now finally able to sustain profitable and reliable rail operations. It makes little sense for the Federal Government to save rail service in the Northeast at the expense of the Midwest.

Third, competition is being weakened. We believe that the lessening of effective competition in the East will have a direct effect on competition in the Midwest, due to the Norfolk Southern-Conrail marketpower. The carriers chosen are not strong enough to compete effectively against the awesome combination of Norfolk Southern and Conrail. A look at their financial results over the last few years makes this clear.

Also, neither can be truly competitive because neither serves enough shippers. Road haul routes look fine on paper, but in the real world both routes and shipper access are necessary.

Mr. Chairman, as I stated at the outset, the C&NW supports the transfer of Conrail to the private sector. We have not wanted to be, nor will we be, obstructionists in this process. We have conveyed our concerns to both the Federal Railroad Administration and the Norfolk Southern. We have attempted to negotiate conditions with the Norfolk Southern that would ameliorate our concerns. Both FRA and the Norfolk Southern have negotiated in good faith with us. However, we just do not agree.

There is a fundamental difference of opinion as to what this merger will do to us and we, as the management responsible to the employees, stockholders, and shippers, felt obliged to bring this to the attention of your committee.

In summary, we feel that the best solution for all is a stand-alone Conrail, achieved either through a sale to a nonrailroad, or some form of public offering. If Congress is unwilling to adopt either of these solutions, we urge you to include the following conditions in any implementing legislation:

First, include meaningful gateway protection for those regional railroads who will suffer significant diversions as a result of this merger;

Second—and I want to emphasize the second is only as a last resort and is not the reason I am bringing my attentions before this committee—recognize that, like Conrail, both the ICG and the C&NW and the former Milwaukee Railroad participated in repayable Federal financing to rehabilitate essential lines. There is justification for placing us on a financial parity with a merged Norfolk Southern-Conrail system if the Conrail debt is to be forgiven.

Third, the Congress should consider permitting the railroads who are being hurt to develop a competitive alternative that will be real and challenging to Norfolk Southern-Conrail. Carriers which will be adversely affected by this merger must be allowed to discuss among themselves with immunity competitive alternatives for the Northeast and other affected areas to be established coincident with any Norfolk Southern-Conrail consolidation. Presumably, this could be done through USRA, Justice, or the Interstate Commerce Commission.

Finally, we urge the Congress to give this sale the kind of scrutiny it deserves. We are not unsympathetic to the need to reduce the Federal deficit and we realize that this appears to be a painless way to raise $1.2 billion toward that end.

However, there are other considerations. The loss of competition and the effect it will have on carriers in the East and Midwest should transcend all other considerations. This is particularly true in that there is every expectation that the Treasury will receive a fair price for Conrail under any sale scenario.

I appreciate the opportunity to share our views with the members of this committee. I thank you for this opportunity, and I would be pleased to answer any questions if I know the answers.

The CHAIRMAN. Mr. Conlon, thank you very much.

I think that you should be assured and all of us should recognize the fact that under no circumstances could it be reasonably said that the sale of Conrail is something that is undertaken lightly or with little consideration or study.

As a matter of fact, the consideration and the study has been prolonged and very extensive. The sale of Conrail was first authorized by the Congress in 1981 when we passed the Northeast Rail Service Assistance Act. When we passed that act, we set in motion a very lengthy process. During that process, the Department of Transportation solicited bids, received bids, hired a financial consultant to examine those bids, negotiated with the various bidders and proposed a recommendation. That recommendation in turn was studied at great length by the Treasury Department and by the Department of Justice.

This is the third day of hearings this year in this committee. We held a hearing last year, as well. In addition to that, the Judiciary Committee has held hearings. It has been a matter that has been very carefully scrutinized and very carefully studied.

I also want to emphasize to you that the primary goal is not to raise $1.2 billion. You know, anything we can get to reduce the deficit, we will take. But the primary interest as set forth by Congress in 1981, was to move Conrail back to the private sector. It was not the present budgetary pressures. Our view is that the Government is good at doing some things, but it is not necessarily good at substituting its business management skills for those of the private sector.

We can agree or disagree on whether the Conrail sale to Norfolk Southern is good. I do not think that there is any possibility that the sale of Conrail to anybody is going to be universally acceptable. If DST had proposed to sell it to Allegheny or to Marriott or had proposed a public offering, all of these would have been subject to great criticism and we would have had all kinds of witnesses coming in to oppose each of them.

I appreciate your opinions and we are, of course, very concerned about your railroad and the health of your railroad. But I do not want any thought to exist that somehow this has not been adequately studied. I cannot imagine a more elaborate, extensive study, or more people being involved in the effort than has been the case here.

As I said before, we have had 3 days of hearings. One of them was an all-day hearing. At all those hearings the room has been filled with people, as it is today, who are very interested in this and watching it like a hawk. It has been carefully covered by the media. All of which is good because it airs the issue.

Senator Pressler and Senator Exon wanted another day of hearings. I was happy to accommodate them. And we are very pleased that you are here to share your views with the committee.

Senator Pressler.

Senator **Pressler**. Well, first of all, I want to thank you very much for your testimony and to say that I think there will be more statements such as yours forthcoming. I have felt that there is an atmosphere that puts some of these smaller carriers in an impossible position for fear of potential recrimination of some form down the line in terms of some of the fears that some of these carriers might have.

If the sale does go forward, they will have to deal with the new monopoly. Also, DOT is pushing this very hard, and I think that there is considerable courage shown here.

Let me emphasize that Chicago & North Western did not ask for this hearing. I asked for it, and they arrived at their decision to oppose the sale. I just learned that they were going to oppose it this morning. And I very much appreciate the points that they have raised, because this is very significant, to have the eighth largest railroad in the United States opposed to this and stating some very carefully thought out concerns.

And I predict that there will be other Western and Midwestern railroads who will also come forward with similar type questions.

I would like to ask these questions to Mr. Conlon. You heard me discuss my concern about the impact of the merger on the Midwest. You covered some of these areas, but in particular, address the area of traffic diversion first, second divestiture, and third market destination control.

Mr. **Conlon**. Senator, I would be happy to. I would like to say that we arrived at our position in opposition very reluctantly, and we did it because of the statement I said, where we are determined not to be obstructionists. We really understand that the administration has a very difficult problem here, that the Conrail problem is one of extreme magnitude, and will bring opposition no matter what happens.

Our concern is that, as it is presently proposed, we have an obligation to say that we think that this is dangerous to the Midwest because of the likelihood of traffic being diverted away. We have had earlier studies, Senator, on what the diversions could or could not be. Those studies were made some time ago. They showed it could be a potential of as much as $60 million.

We have asked this consultant to go back and do it again as hard as he can, and when that is done we will bring it to your attention if you should care to have that information.

As a historical sense, it has been obvious to people practicing railroading in this country that there is competition between the Chicago and the Kansas City gateway for east-west traffic. It is there, it is on the map, and it is known.

The diversions, how much they will is where reasonable people can differ. I feel they will be of magnitude. But whether there will be diversions, I cannot see any real argument.

Senator PRESSLER. Now, on the market destination control and the other issues, are there other regional railroads which you are aware of that have problems with this merger proposal who might be similarly affected? I know you are only speaking for yourself.

Mr. CONLON. I did support the Illinois Central Gulf's position, which had expressed similar concerns to this committee about the future of their gateways, I believe the Effingham gateway. And I am told that other railroads—but I prefer, Senator, to let them make their own public statements—are now moving toward opposition, for the very reasons that I am stating.

Senator PRESSLER. Now, did you attempt to enter the divestiture process?

Mr. CONLON. Not really. We discussed it with the Federal Railroad Administration. We did run a study through independent consultants as to whether there was an opportunity here, and we had preliminary discussions with the Norfolk Southern. But we did not attempt to enter into the divestiture process.

Senator PRESSLER. Now, you have heard my concerns about traffic diversions being ignored or at least not fully considered in the competitiveness and divestiture issues as they relate to the Midwestern regional carriers. Do you agree, or can or should the traffic diversion calculations be added into the picture?

Mr. CONLON. Well, I think they absolutely should be added into the picture. And when the chairman mentioned the exhaustiveness of the activities by the Department of Transportation and by Justice, I want to say that I did not intend to be critical.

What I intend to point out is that I think that the Justice overview was limited by virtue of treating it as a Northeast problem and that the diversions and the potential changing of the stability and the viability of connecting and relying on carriers should be included in the Justice Department overview, and I have not seen it in the Justice Department report.

Senator PRESSLER. Could you comment on my concern about the ripple effect of a Norfolk Southern-Conrail merger on branchlines in States in the Midwest? Specifically, assuming traffic is diverted from a Midwestern carrier's mainline, Chicago & North Western, for instance, could it affect the branchlines in smaller States, Midwestern States, or Western States?

Mr. CONLON. I believe it very well could affect the branchlines, because of the unique configuration of railroading in the Midwest, especially the upper Midwest.

I am not sure what the red light means.

Senator FORD. It means stop.

Mr. CONLON. Senator, that is what I do best.

The CHAIRMAN. Why do you not finish your answer.

Senator FORD. I am just jovial. People do not pay any attention to me. I just have a good time. It is the only time we can laugh around here. Everyone is so serious.

Mr. CONLON. I am glad. I am just getting over being scared.

The CHAIRMAN. Mr. Conlon, as a general rule red lights in Washington do not mean very much.

Mr. CONLON. We have a railroad which has 11,000 employees, and I think you get back to the statistic I quoted. We have 7,500 miles of railroad. Seven percent of that railroad holds up 47 percent of our tonnage. That means the rest of it is being held by that bedrock. That is the bedrock upon which this organization and this rail structure is upon. If you attrite that strength, you are taking a chance of attriting the limbs and the arteries and the appendages.

Senator PRESSLER. I have some more questions, but I will yield to my colleagues because I have a red light.

Senator FORD. Two or three questions, Mr. Conlon. Did I take your statement to Senator Pressler a moment ago to mean that you are speaking for ICG or relating their public position?

Mr. CONLON. They have informed a committee of their concerns and I have said we support their concerns. I am not authorized to speak for them, but I can say we agree with what they said.

Senator FORD. I am just reviewing this. Both the ICG and the C&NW have participated—I just wanted to be sure.

Now, you indicated that you looked at the situation very carefully and decided not to participate.

Mr. CONLON. In the divestiture?

Senator FORD. Yes. Now you are saying that we ought to let you participate. Why did you not get into it before? And now you have decided, after the decision was made, that you want to get in. It is like that fellow who ran the touchdown and wanted to call it back.

Mr. CONLON. I am not above doing that, but I do not think I am doing it this time, Senator.

Senator FORD. I think we are going to get along. You are honest.

Mr. CONLON. Senator, I am not asking to be included in the divestiture process. We are very clearly saying, we thought and hoped that the final package would address the ripple effect from the Northeast into the Midwest, and we tried very hard to have that either done through the administration's program or through a private agreement with other carriers.

Failing in that, we feel an obligation to state that as it is so configured today it would be harmful and suggest that remedial legislative language would be appropriate so that solving a big problem in the Northeast will not hurt the Midwest.

Senator FORD. All right. You would need antitrust immunity in order to do what you are suggesting, with the various companies getting together. Would a Justice Department letter be good enough, or would there have to be some legislation that would give you antitrust immunity in order to sit down and try to work out a package?

Mr. CONLON. Well, Senator, I am not an antitrust lawyer.

Senator FORD. You have looked at this, and you have said you need immunity. How much immunity do you need?

Mr. CONLON. I do not know. Senator, the answer is we have a 401 proceeding now in place. If that would give us enough to be able to talk together without being in jeopardy, we do not need more. Commerce counsel tells me that they have some concerns and I am frankly not smart enough to articulate them without talking to good commerce counsel.

Senator FORD. That is fine. I just wondered how much and how far we have to go.

Mr. CONLON. I apologize for my lack of knowledge.

Senator FORD. That is all right. Do not feel like the lone ranger. You suggest a public offering.

Mr. CONLON. Yes.

Senator FORD. How much do you think a public offering would bring, and how long would it take the Federal Government to sell if you have a public offering?

Mr. CONLON. Well, I have supported and we continue to support a public offering, because that is a stand-alone Conrail. A stand-alone Conrail obviously does not bring with it the competitive concerns that we have today, because it holds in place the competitive situation that I have now built my economics upon.

In order to comment upon what the financial markets would take, I would really have to comment on the historical statements I have read. For example, I do know that there has been a private offering proposed by the management of Conrail that has been supported by Morgan Stanley, that stated that there was an appetite up to $1.2 billion. I know that there have been other issues.

As to what the appetite of the private market would be at a given date, I do not know.

Senator FORD. It would be basically other railroads that would buy it, would it not?

Mr. CONLON. I could see many people participating in the purchase.

Senator FORD. Big chunks of money would come from other railroads?

Mr. CONLON. That is one of the proposals I have heard, yes.

Senator FORD. Do you lease cars? I mean, do you have cars that you lease to other lines?

Mr. CONLON. Senator, yes, we do. We lease in our own account. All railroads do, or at least most. And then by virtue of the way the railroad system interlocks, our rolling stock is used by many other railroads in a constant flow of traffic across this country.

Senator FORD. Who do you lease to?

Mr. CONLON. I have to make two distinctions. There are times when we have a traditional lease, where you would take cars like to Conrail for 100 cars for a 6-month period.

Do I have to shut up yet, sir?

Senator FORD. No.

Mr. CONLON. The normal thing is what is called per diem rental and that is a daily rental of the free-flowing interchange of cars, and all of our cars, I hope, get used by other railroads and they pay us to use them. So it would be all railroads.

Senator FORD. Who is your largest leasor of railroad cars?

Mr. CONLON. Our largest interchange of traffic, so I would assume that they would be the largest on the per diem—and I am guessing here, but I think it is a good guess—would be the Union Pacific Railroad. Our second one would be Conrail.

Senator, we are a bridge carrier.

Senator FORD. Who would your third one be?

Mr. CONLON. There are many that fall in here. It could be—we do have interchange with the Missouri Pacific, the Kansas City Southern, with the Santa Fe. I would have to look.

Senator FORD. I think I know. That is the reason I asked the question.

Senator EXON. Mr. Conlon, I am delighted to have you here and I am very much favored over my colleague here because I guess this

Senator and you have been probably in more hearings and meetings than both of us care to remember.

I want to explain to my colleagues that Mr. Conlon appeared every year for 8 straight years before the Board of Equalization when I was Governor in Nebraska. And I must tell you that we had the same reaction to him, Senator Ford, that you have. We always felt that he livened up the proceedings because he was always very forthright in his answers.

I am just delighted to have him here as a chief executive officer of a major important railroad to our section of the country. I used to listen to him before the Board of Equalization when he was complaining about the taxes that Nebraska was assessing, stating that he would be out of business. But I am glad that we were not too hard on you, Jerry Conlon.

Mr. CONLON. Senator, that is the only reason we are in business.

Senator EXON. I am very pleased that you came in.

One of the difficulties we have had, frankly, Mr. Conlon—I have not made up my mind on this Conrail sale proposition, but I have been somewhat concerned about the fast track, to coin a new phrase, that this seems to be on.

We have been awaiting input and advice from the other two main railroads that serve Nebraska, and so far—I am talking about the Burlington Northern and the Union Pacific—they both basically seem to be saying, well, you know, we are studying this and are going to come forth with a recommendation at some appropriate time.

The train may have left the station if they wait too long. So I very much appreciate the fact that at least the Chicago & North Western has taken a stand, and I listened with great interest to your testimony.

Can you, or do you care to, speculate as to why the two railroads that I have mentioned, and others that I would think would be adversely affected—if there is indeed an adverse effect on them and their customers—why they have not come forth as you have in your railroad?

Mr. CONLON. Speculation like that would probably be a big mistake, Senator. They are in this room and for me to speculate—if you could get them to leave the room, I will tell you.

Could I suggest one thing? One of the reasons that we are coming forward is that we are relatively smaller. Therefore, the fragility or the ripple effect has a greater effect upon us. And these other railroads are fine railroads and they are larger and I think have to take a more universal look at the world.

Senator EXON. Can you tell me what your suspicion is as to why this sale has been placed on a fast track without us here in the U.S. Senate even having a significant chance, I suggest, to even look for hot boxes and maybe tortured, twisted rails somewhere along? Why is it that, in your view, this is on—that we are proceeding with such speed on this?

Is there some concern that if we do not proceed with speed, some flies might show up in the ointment?

Mr. CONLON. Here I am also dangerously speculating, but this time I think I will. The Government, the Department of Transportation, has got a very difficult job in front of them. This Conrail situation is one where they have a charge to get rid of a very large railroad, and I have sympathy and appreciate the magnitude of the problem.

Having just gone through an unsuccessful attempt to acquire the Milwaukee Railroad in a similar situation of a parallel merger, I have experience that the longer you hang out there the worse it gets. And so frankly, if I had the Department of Transportation's obligations I would have great sympathy to try to get this done as soon as possible, because the longer it hangs out there the more the competitive problems become irritants and not constructive.

I am not really quarreling with the quality of the Department of Transportation's product. I am saying that my concerns, which I think are significant, have not been melded into the final product.

Senator EXON. Have there been conversations between you and your railroad and the other major railroads that serve the Midwest? Have there been conversations, informally or otherwise, between the chief executive officers of these railroads with regard to the proposed sale of Conrail?

Mr. CONLON. There have been conversations in terms of industry gossip. I am sure that our industry is no different than anybody else, where someone would say, where are you? There have not been any structured, to my knowledge, conversations toward a goal oriented other than gossip.

Senator EXON. Mr. Chairman, my time is up. Just one brief short question.

In your statement, you give three suggestions for changes that should be made. I assume, and I hope I assume correctly, that if one, two, and three were incorporated you would feel that this sale could go forward?

Mr. CONLON. If one, two, and three were implemented into the enacting legislation, even though we still prefer a stand-alone Conrail, we would not be coming before the Congress and testifying in opposition.

Senator EXON. Is there any particular order of importance there, or are they all tied together?

Mr. CONLON. No. 1 is the most important. We are looking for—basically what we are saying is that there has been experiment here, there has been a lot of Federal money to solve the problem in the Northeast. The final result should not be to hurt the Midwest, and we perceive that as it is now structured it could do that, and that should be addressed by the Congress.

Senator EXON. Thank you, Mr. Conlon.

Thank you, Mr. Chairman.

Mr. CONLON. Thank you very much.

Senator PRESSLER [presiding]. Thank you.

Let me just ask you one final question. Let me say that the purpose of this hearing, as I see it, is to try to build a legislative record that might be useful in the future, but also to give you an opportunity to express yourself, as you have.

As a practical matter, I think it appears to everybody that this sale is going to go through or go forward in one form or another. I think a lot of the carriers are, very frankly, afraid to step forward because they are going to have to deal with the new situation and DOT is very interested in seeing it go forward and so forth. That is just my opinion. That is why I think we have not heard more in terms of concerns.

I think I have covered all my questions except one. I would like to focus particularly on my earlier point about market destination control and how it relates to your traffic flow picture.

Now, as this would work, let us say that Conrail were sold and Norfolk Southern were operating it. What would be the worst case scenario in terms of your traffic flow picture?

Mr. **Conlon**. Addressing the studies that we have had done, we feel that the Conrail-Norfolk Southern combination would over a period of time favor the Kansas City gateway, because that is the longer haul and would give them more money for their own coffers.

We also feel that a railroad of that strength and magnitude, a Conrail-Norfolk Southern Railway, would be a gigantic monolith and would have market power over the people who it either receives from or ships to that could be material, and also could affect further—and I have already outlined—the flow of east-west traffic.

Senator **Pressler**. Now, why could we not try a public offering, and if that did not work then have a sale? What would your view of that be?

Mr. **Conlon**. I will give you a personal view and one which I would couch by not being an expert, because I have followed both sides of this. The reservations that have been expressed about a public offering would be that the market appetite is such that it would have to be done in a series of transactions and that at some point in those transactions the Government would be a minority holder and at that point it would freeze and the Government would be in perpetuity a minority holder.

I have personally thought that that depends, one, upon the market appetite at that time, which an investment banker would be more qualified to state than myself; and two, upon the undertakings upon which the first parts of this series were undertaking.

I could see where understandings could be entered into that the Government at one time when the appetite of the market came back could get rid of it. Now, I pretend no real expertise. I used to be in finance. I knew a lot about it then. But that is just my personal opinion.

Senator **Pressler**. Senator Ford.

Senator **Ford**. Tell me, what is a gateway contract and how many gateways do we have in this country? Do you have any idea? You talk about the Kansas City gateway, you talk about the Chicago gateway, Baltimore, New York. You begin to talk about all gateways.

Mr. **Conlon**. A gateway is a traditional area where one railroad hands off traffic to another railroad.

Senator **Ford**. When you say "hands off traffic?"

Mr. **Conlon**. I will give you an example. Conrail would get some traffic in New York destined for Los Angeles. It will take it to Chicago. We call it a gateway. We pick it up and we take it to Omaha, and then the Union Pacific picks it up.

They have options. They can take it to other gateways, and that is really what we are talking about, Senator, a change of the way traffic is today moving.

We exchange 200,000 cars a year with Conrail. We see, maybe not today but in the long run, the longer haul possibly being Kansas City under this combination. Normally, if this were the case we would take these concerns to the Interstate Commerce Commission. There would be statistical evidence, there would be experts on both sides, and then that deliberative body would determine whether or not either side has a substantive problem.

This is a unique kind of issue to bring to a political forum. But we are talking about the gateway is where we receive traffic or give traffic to another carrier.

Senator FORD. Do those gateway contracts include rates employees pay? What is included in a gateway contract?

Mr. CONLON. Basically, it is just a tariff arrangement that the traffic can be routed that way. The other arrangements as to the undertaking for labor are not part of that. Railroads can enter into those, but that is a separate kind of agreement.

Senator FORD. Well, I have heard rumors floated around—as you say you have heard rumors, but antitrust keeps you all from talking. The rumors fly up here, too, about the New York gateway. That seems to me to be the one that basically labor would like to keep.

What is in the New York gateway contract that would not be in the Kansas City gateway contract?

Mr. CONLON. I do not know. I am just a parochial Midwesterner.

Senator FORD. Oh, come on. That is like a fellow saying, I am just a country boy here to find out something. You did just spend $150 million on all of these good things, and you are the 11th largest and you swap 200,000 cars. Do not give me that now.

Mr. CONLON. You are right, Senator. I apologize, too. I should not have done that.

Senator FORD. Well, that is all right. I apologize for putting you in that spot.

But answer the question, would you, please.

Mr. CONLON. Unfortunately, I really do not know. I would be happy to get for you—I know what gateways are. I do not know what labor's concerns are. Your concern about the New York gateway would be——

Senator FORD. I am just saying that that is one that I keep hearing about.

Let me ask you this. If you now have a contract with a railroad, say Seaboard, to go through to the Northeast or something like that, how would you prevent Seaboard from entering into a contract in Detroit, MI, so that they would go through your lines or have to go through Chicago carrying coal out of East Appalachia to some point beyond Chicago?

Mr. CONLON. It would depend on the terms of the contract you had entered into with them.

Senator FORD. With whom now?

Mr. CONLON. With the other carrier.

Senator FORD. So you have to enter into a contract?

Mr. CONLON. We do have agreements with other carriers to do things in a coordinated manner. For example, the Grand Trunk and the Burlington Northern have a voluntary coordination agreement to handle traffic in that area of the country.

Now, I have not read the contract, but I assume—and I have seen prototypes of these things where it is contractual undertakings based on considerations tendered by both sides. And whether or not another movement would be a breach or, you know, a difference depends on the contract. And we do not do the cancellation procedures.

Senator FORD. So a railroad would hold a gateway unto itself, and if you wanted to get through that gateway you would have to make an arrangement or a contractual agreement with the railroad that has that?

Mr. CONLON. Yes.

Senator FORD. So we are really talking about some railroads holding other railroads captive, and they could not get through unless they paid the piper, is that right?

Mr. CONLON. That is one consideration. It is not the direct consideration here, Senator. There is concern about closing rates and routes to carriers, and that I think is what you are talking about, where a railroad can get frozen out by virtue of this fact that it is small.

Senator FORD. Well, you could get frozen out if you are big. The bigger you are, the more apt you are to be—I mean, the smaller, to be frozen out. I guess that is what you are worried about.

Mr. CONLON. The smaller you are, the more apt you are to get frozen out because you lack market power.

Senator FORD. Well, it seems to me that Seaboard would be big enough to be in competition with others. They are the main carrier of coal through my part of the country. That is the reason I raised them. There are captive shippers there—we are captive. And whatever rate Seaboard charges, that is the rate we have to pay.

And then they say that the gateways prevent them from lowering their price and that sort of thing. That begins to get into—I am going to look at gateways. That gets into our conversation here, and a gateway not only involves a contract between railroads but also has labor aspects to it. All these things, as I understand it, are part of a gateway, and they are throwing gateways at us. I am going to become a little more interested in gateways, because you are preventing—not you—but the gateway is preventing in some respects the ability to ship coal today.

And you say you want to take it to the ICC. They are trying to get rid of the ICC. Where would you go if they got rid of that? To the Department of Transportation, I guess?

Mr. CONLON. I would suppose so, Senator. I did not really say I wanted to take it to the ICC.

Senator FORD. You said you would take it to the ICC.

Mr. CONLON. I said in a traditional way this would be handled in a forum like the ICC, a more deliberative forum than a normal political forum.

Senator FORD. Well, I am beginning to see that the competition is not everything out on top of the table. And the more you get into these gateway questions, it is like if you do not have it and you want it you have to get it from me. So there is no competition there, is there?

Mr. CONLON. Senator, I did not understand that statement.

Senator FORD. If you had the gateway and it is yours, and I want to get through, if I do not pay the price or do not sign an agreement with you as it relates to tariffs or whatever it might be, I do not get through, do I?

Mr. CONLON. There are elements of law which would discipline this, but you can make the statement that there is—that, you know, a railroad would have the ability to cut off traffic at a gateway.

Senator FORD. So they do have the ability to cut off your traffic at a gateway?

Mr. CONLON. To some extent.

Senator FORD. To some extent. Well, some extent could be devastating, could it not, if you are on the margin?

Mr. CONLON. It could be.

Senator FORD. Thank you, Mr. Chairman.

Senator PRESSLER. Senator Exon.

Senator EXON. Thank you very much.

Senator PRESSLER. I just want to follow up on that fine question by Senator Ford. In other words, to make this graphically clear, if Norfolk Southern and Conrail merged going the other way, they would control the gateways going East from Chicago, Kansas City, and St. Louis, is that not correct?

Mr. CONLON. They would have a lot of power there. I would not say that they control it.

I want to make this part clear. In the Norfolk Southern-Conrail situation, I believe they would leave the routes open. I have never heard that——

Senator PRESSLER. They would leave them open, but there would be no way to connect it to except them.

Mr. CONLON. Oh, I think they would. I just think that the power they would have over traffic will be diverted to a longer haul. I am not suggesting unilateral language that would arbitrarily cut off competition in that environment.

Senator PRESSLER. The gateways would be open, but there would be nobody to carry it, to carry the products, except them. So there would be no point in going through the gate.

Finally, I would like to see you submit some specific language on legislation on an amendment that it would take to establish meaningful gateway protection for those regional railroads who will suffer significant diversions as a result of the merger.

Mr. CONLON. We would be very happy to do that, Senator.

Senator PRESSLER. Good.

Thank you very much.

Mr. CONLON. Thank you very much.

Senator PRESSLER. As I understand it, our next witness is the Honorable John Riley, Administrator, Federal Railroad Administration. And then we will hear from two witnesses together, Mr. Watts and Mr. Wilson.

The Honorable John Riley, Administrator, Federal Railroad Administration.

STATEMENT OF HON. JOHN RILEY, ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION, DEPARTMENT OF TRANSPORTATION, ACCOMPANIED BY CHRIS ROONEY, DEPUTY ADMINISTRATOR

Mr. Riley. Mr. Chairman, this is going to take me just one second, because I thought, in light of some of the earlier questions, that I could illustrate something for the committee with a chart that I just had them bring up from my office.

Senator Pressler. Do you want the other witnesses to go first?

Mr. Riley. No. I am prepared to go now. I just want to move the chart here.

I will confess to the Chair that this is a complete ad lib, so I apologize for holding up the committee. But I thought, in light of the discussion on gateways, it might be helpful to illustrate a gateway with a gateway chart that we have.

Well, I do not know if I can say young woman any more, but there is a young woman in our office named Betty Ward who has been a career civil servant for over 20 years and she makes charts for just about everything. And it is amazing how often, when you do not think you are going to use one or need one, it comes in handy. So I hope this will be illustrative for the committee. We will be glad to do a breakdown of this and provide it to you to keep.

Thank you, Mr. Chairman. I am John Riley and I am the head of the Federal Railroad Administration. To my right is Chris Rooney, who is the Deputy Administrator.

In light of some of the issues that have been raised this morning, Mr. Chairman, if I have your approval I would like to submit [1] my written statement and really address some of the issues that were raised in the first testimony.

Senator Pressler. Without objection, we will take your written testimony and we welcome your extemporaneous statements.

Senator Ford. Where is your statement?

Mr. Riley. I do not have it in my own hands. We will provide it for the Chair. It deals with diversions and I think you may find it helpful.

Senator Pressler. I do not have it either.

Senator Ford. I thought we were supposed to have it in advance.

Mr. Riley. I do not know. That may well be our error, Mr. Chairman.

Senator, as you know, I am a Minnesotan, and I have spent the better part of my life working to stabilize the Midwestern transportation system in my State, as you have in yours. And the interests of Midwestern shippers were really predominant on my mind throughout all of the negotiations we did on this issue.

There are three issues, I think, that come out of the testimony we have heard this morning. I would like to raise them and answer them and then answer questions that you might have on them.

The first question would be, what kind of options will Midwestern shippers have after the sale, particularly compared to the options they have today?

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[1] There was no formal written statement.

Second, can the Guilford system really compete in the markets and over the lines that it is gaining?

And finally, what is the impact of this sale on other Midwestern carriers?

I will go to the first question: What kind of options do Midwestern shippers have today and what will they have after the sale? As the maps illustrate, there are two principal eastbound gateways for Midwestern traffic, both agriculture and nonagriculture. They are the Chicago and the St. Louis gateways. They are the juncture points at which the Western regional railroads meet the eastern regional railroads.

Today in Chicago, pre-NS/Conrail merger, there are four options for shippers going east. First, they can go Conrail, which serves the majority of the Northeastern ports and destinations. Second and third, they can go CSX or they can go Norfolk Southern, which serve the majority of destinations in the South and go as far east as Buffalo. Finally, they can take Grand Trunk and go north via the Canadian railroads into the Northeast.

What will the situation be after the merger? After the merger there will still be four options in Chicago for Western and Midwestern shippers. There will be Norfolk Southern-Conrail, which will serve all of the points in the Northeast that Conrail served before.

But now, in addition, there will be the GTI or Guilford transportation industries illustrated in green on that map. The Guilford system will also provide single line service from Chicago to the major Northeastern destinations. So in other words, where there was previously one carrier on the termination end in the Northeast, there are now two.

On the southern ports——

Senator **Pressler**. That is to the ports, but not the cities?

Mr. **Riley**. Cities and ports, Mr. Chairman.

On the southern destinations—in fact, I should have said destinations. On the southern destinations, there will still be a Norfolk Southern and a CSX. And finally, Grand Trunk will still be present as a connection to the North and to the Canadian railroads.

So the bottom line is, in Chicago, and then I will talk about St. Louis, where there were four railroads competing in Chicago before, there will be four railroads competing in Chicago after the acquisition. But there is a qualitative superiority in that, while previously there were two carriers to the South and one to the Northeast and one to Canada, there are now two to the South, one to Canada, and two to the Northeast.

Now, on St. Louis it is somewhat similar. Today there are three principal gateways—I'm sorry, three principal connections in St. Louis. One is Conrail, which goes to the Northeast; one is the Norfolk Southern, which goes to the South and as far east as Buffalo; and the third is CSX, again which goes to the South and as far east as Buffalo.

After the merger there will still be three. There will be the Conrail-NS system which goes to the Northeast and to the South; CSX, which goes as far as Buffalo and the South; and again the Guilford system, which also goes to the Northeastern destinations.

So the bottom line in St. Louis is the same. The number of competitors in the gateway will remain the same, three, but there is a qualitative superiority because, while there are still two competitors for southern business, there will now be another single line competitor for northern business.

Now, the second question stems from the first: Can the Guilford system really compete in the markets it is gaining access to? Are these divestitures real? And I think the Chairman made a point in his opening statement that I would agree with. If NS had the unrestricted right to do the choosing, and there were no independent review by the Department of Justice, Mr. Chairman, I would be opposing this merger.

But when the Department of Justice mandated the divestiture of certain lines, they retained jurisdiction over this case. The Department of Justice did not attempt to tell the Norfolk Southern who they had to make the divestitures to. They left that to the market. But the Department of Justice retained jurisdiction to reexamine the deals that the Norfolk Southern had cut and to approve or reject them based on several criteria, including:

The financial viability of the selecting carrier;

The connections available on the line: Are they real connections? Is it real competition?

Now, we suggested, "we" being the FRA, to the Norfolk Southern that they should favor divestitures to the eastern regional carriers, and the reason was this. We felt it was important on that line to have the line owned and run by a carrier whose operations are centered in the Northeast region, so they would have a long-term incentive to build traffic on that line and serve northern communities, rather than simply use it as an expressway for Midwestern or Western traffic to the East.

Second, there is no competition for Conrail now in its service area other than these regional railroads. Whether you will have competition in the future in that area is a function of whether they can survive and compete. This is a once in a lifetime opportunity to lengthen their hauls and ensure their survival.

But I want to emphasize in the strongest possible terms that Norfolk does not have the right to choose the buyer and they do not have the right to choose the lines. They will recommend. Justice will make a final decision. And DOT, as I can tell you, has no control over that.

Now, let us talk about the deal that is on the table. An arrangement has been reached, and we called it an agreement in principle because Norfolk does not have the right to sign a contract. And what it does is it divests approximately 1,700 miles of line, basically to the Guilford system.

I am often asked the question, is the Guilford system going to be able to compete with the gigantic Norfolk-Conrail system all over the East? And the answer is, of course, it is not and it is not designed to. The Justice Department found that east of Buffalo and east of Pittsburgh this is an end-to-end merger. There is not one mile of overlapping line. It is an end-to-end merger.

All of the competitive issues that Justice found occur west of the Buffalo and Pittsburgh gateways. There are approximately one dozen areas in that region where the Justice Department found that the merger would reduce the number of carriers from two to one or three to two. In those areas, NS was mandated, to construct a structure that would bring in a new competitive carrier to bring the number of carriers back up from one to two or two to three.

Now, will Guilford work? In my personal opinion, subject to the Justice Department's acceptance or rejection, it will, for several reasons.

First, these are good lines. Freight traffic conventionally moves at 40 to 50 to 55 miles an hour. The line from Buffalo to Cleveland, the anchor of the Guilford system, is a 60 mile per hour signaled line. From Crestline Junction out to Chicago, it is a 70 mile per hour signaled passenger line that Amtrak runs on today.

These lines are authorized for speeds far in excess of speeds that the freight will ever have to move at. No segment of this system is authorized for speeds under the 40 miles an hour that the freight will need to move on. The lines are good lines.

Second, they interconnect with single line service virtually all of the points that must have new competitive access.

Third, under the mandates of the Justice Department, Guilford has to have at least as much competitive access as the carrier that it replaces in terms of reciprocal switching access, and that is in fact created.

Fourth, if you look at the traffic that is accessed to the lines of the new Guilford system, recognize this: It not only has all of the traffic that the Guilford system has today and now sends up into Canada at Buffalo or in Vermont; it has the traffic in the points, the 12 new markets, that it is permitted to enter. It also in Chicago and St. Louis, interconnects with, and can potentially take traffic from, the Burlington Northern, the North Western, the Union Pacific, the Missouri Pacific, the Southern Pacific, the Santa Fe, the Katy, the Kansas City Southern.

The point I want to make to the committee is that the Guilford system has access to more than half the freight traffic in the country that moves east from the West. There is no question that sufficient volume is available on these lines.

The only question left on the limitation of this system in its ability to compete economically is management, and there should be no question about their management. Eighteen months ago the Guilford system took three railroads, two of which were in bankruptcy. Eighteen months later, without any Federal assistance or special legislation, that system is profitable. They have done, in effect, the kind of turnaround that Conrail has done.

Mr. Chairman, that is my view on the success of that system. The answer to the second question in my judgment is yes, Guilford can compete. But I do not have the right to answer it. The Justice Department will answer it in the end.

A final point on question No. 2. Do not lose sight of the fact that Guilford is not the only competitor in these markets. CSX, with one exception, is in every one of these markets that the Guilford system is being allowed to enter, and they are a strong and worthy competitor to the Norfolk Southern system.

Final question: What is the impact on other Midwestern carriers? This is an issue that we have studied and we have studied hard from the beginning. There is no question there will be some traffic diversions, at least initially, and the reason is that Guilford, in its own way, and the Norfolk Southern can offer Midwestern consumers lower prices and better service on some categories of goods. And in our view there is nothing wrong with that. That is what we should be trying to do.

Now, the secondary question is, will the diversions be so great as to threaten the existence of these carriers? In our judgment the answer to that is no. In every case that we have analyzed, the probable diversions fall at or below 2 percent of volume, which is the kind of fluctuation one can get in a normal marketing year. That ranges all the way from the Burlington Northern and the Katy and the Milwaukee, which have no diversion or less than 1 percent, up to the North Western, which has diversions up in the 2-percent range.

Now, in viewing diversions I urge the committee to keep one thing in mind: Distinguish between divertable traffic in the aggregate and divertable traffic that comes about as a result of this merger. Let me explain what I mean.

I want to make a comment on some of the statistics cited by my friend Jerry Conlon, and let me tell you, Jerry is my friend. I have great respect for the North Western Railroad. I not only like them as people; they owe me $168 million. I have, therefore, a very strong interest in their future.

But much of what Jerry said was legitimate. Some I would disagree with. Let me illustrate. The North Western Railroad picks up between $50 million and $60 million worth of business from western carriers at two gateways. Basically, at one gateway in Omaha, the Northwestern links up with the Union Pacific. Now, the point that the North Western made a few moments ago is that the traffic which the Union Pacific now takes to Omaha to link up with the North Western could be diverted south to Kansas City, where the Union Pacific links up with Norfolk Southern.

That is true, but that situation exists today. Norfolk Southern does not acquire its linkup in Kansas City due to this merger. As the map illustrates, Norfolk Southern links with the Union Pacific today in Kansas City. And if, in fact, the Union Pacific were inclined to divert the Omaha traffic down to Kansas City and put it on the Norfolk system, they could do that today.

They do not do it for two reasons. One is just an efficiency and length of haul reason, and the second is a little more complicated. The divisions in the gateways favor the western carriers more at Omaha than they do at Kansas City.

Senator **Pressler**. If I could interject, Senator Gore has a commitment and he wants to ask you a question.

Mr. **Riley**. That is fine. I will wrap up.

Senator **Pressler**. Why do you not let him ask his question.

Senator **Gore**. If you are going to finish briefly, that is fine.

Mr. **Riley**. I will finish this and I will yield to your question.

The point I am making is, yes, there are diversions that result from this merger on the North Western. We estimate them to be in roughly the $12 million, or near 2 percent, range.

There are other potential diversions to the Norfolk Southern that could bring the divertable traffic up into the $40 to $50 million range, but those diversions are not a result of the merger. They could occur today. And so my point to you is to distinguish between diversions as a result of the merger and diversions that could occur today.

These are complex issues, and I appreciate the committee giving me a chance to extemporize a little bit and lay this out. I will be glad to answer any questions.

Senator **Gore**. Mr. Chairman, I want to thank you for your courtesy, and I want to thank my colleagues for their courtesy in letting me get a short question in before I have to depart.

I understand and fully realize that this hearing was scheduled principally to look at the impact of the Conrail sale on Midwest transportation. But since this may be the final Senate hearing on this extremely important proposal, I wanted to briefly ask Mr. Riley some questions about another aspect of the proposal, and you may respond for the record if you are not prepared to do it here today.

And I ask them, quite frankly, because we have not—my office has been in contact with the Department, and we have not been able to get satisfactory answers on this aspect.

I began my review of this issue several weeks ago with a completely open mind about the proposal, and I even stated that I would like to be in a position to support the Secretary's proposal. She has made a very persuasive and thorough case in its behalf.

But I must say that I am troubled by the wide-ranging reports about flaws in this proposal, and the stakes are very high, too high to rush through the legislation without fully understanding all the implications. Now, I am not now opposed to this bill or to the DOT proposal, but I simply want some more answers before I cast my vote later this month.

Specifically, I have been contacted by employees and shippers of CSX and communities along its lines with some concerns which I asked for the help of the Department in addressing, and really the answers have not been quite satisfactory.

The employees of CSX have been led to believe that if this merger goes through, as many as 20 percent of all CSX employees will be laid off. They claim that CSX will have to abandon trackage and, because of dramatically reduced revenues, it would have to reduce employment significantly. I want your comments on this projection.

As I said before, to date the answers have not been particularly reassuring at all. I would like you to provide to the committee a Department analysis of the speculation I have just mentioned about the necessity of layoffs, service losses, and track abandonments. I would like to get a response in writing before the committee vote if that is not an unreasonable request, so that I will have the time to analyze it and see what it involves.

And you know, Norfolk Southern is a very good corporate citizen in Tennessee. It serves many communities and shippers and is by any measure an outstanding railroad with sound management. I have no doubt that it could take on Conrail and do a great job.

CSX is also an important corporate citizen in Tennessee. I have been disappointed with some of their continued efforts to abandon lines, but that is another issue. I do know that thousands of CSX employees in Tennessee and some shippers and communities served by the railroad are deeply concerned with this proposal. These are hard-working men and women who have been hurt by past mergers, deregulation, and competition from other forms of transportation.

Communities are threatened with the entire loss of rail freight service. Now, if that is to be outcome of this proposed measure I believe we may be moving too fast to approve the plan. I hope the Department can give some firm assurances about these problems before we vote on the proposal.

And I again appreciate the indulgence of my colleagues.

If you have a brief oral response at this time, and then a supplement for the record or to me or my office, please go ahead.

Mr. **Riley**. Senator, I would be glad to. Because this is obviously a complex question, I will submit to you a lengthier written response.

But let me say in overview, obviously this concerned us from the beginning and we looked hard at it. The lines the CSX is referring to are the Baltimore & Ohio Railroad system. Essentially, the CSX President has said that he would seek to abandon it if this deal went through. Let me say in overview that a railroad cannot abandon lines simply because it chooses to do so. It must establish that the lines are noncompensatory; that is, it must establish that the lines flunk essentially the financial tests that the ICC sets up for abandonments.

Our analysis shows that there is no similarity whatsoever between these lines and anything that could possibly be eligible for abandonment. The lines, the B&O plus the portion of the Chessie System that they are talking about abandoning, carried over 26 billion—billion—revenue ton-miles last year, a very heavy volume.

Now, I made that point at our last hearing and a few days later I understood that CSX said: Yes: but that is tonnage; you are not talking profit, and profit is the issue. So I have researched the profit numbers. Those lines yielded a profit of about 5.4 percent on a net—on a net basis.

Senator **Gore**. All right. I think that I have transgressed on the committee, on my colleagues too much. If you would expand on that for the record.

But let me just add one thing. They are not just singling out that line. They are leading their employees to believe that there is an across-the-board threat to 20 percent of all the employees in the system. And I want a good detailed response on that so that I can take it back to them and find out wherein the truth lies.

Thank you, Mr. Chairman, and I thank my colleagues.

Mr. **Riley**. I would be glad to do that, Senator. I would be very happy to do that.

[The following information was subsequently received for the record:]

U.S. Department of Transportation,
Federal Railroad Administration,
Washington, DC, April 15, 1985.

Hon. Albert Gore, Jr.,
U.S. Senate,
Washington, DC.

Dear Senator Gore: I write to provide the followup information you requested on the CSX Corporation's threat to abandon service on the Baltimore and Ohio Railroad (B&O) should Norfolk Southern succeed in acquiring Conrail. There is no basis for that threat, and it is unfortunate that CSX would use this tactic, with its own employees, in an effort to build a political base against the Norfolk Southern-Conrail merger.

First, it is essential to recognize that no railroad can abandon service on a line simply because it feels like doing so. ICC regulations are clear and specific in permitting abandonment of service only when volumes have fallen on the lines involved, to the point where the lines are noncompensatory. Even then, the Commission must make a finding that the public interest is best served by permitting the abandonment, a finding that is normally predicated on data indicating that losses on the lines are so severe that they threaten service in other parts of the railroad system. The criteria are extremely clear, and railroads rarely file abandonment petitions unless the financial statistics and convincing fashion. This reticence to file abandonment petitions unless performance has clearly deteriorated below the statutory criteria is the reason why so few abandonment petitions are actually denied.

By no stretch of reason or numerical sleight of hand could the performance on the B&O lines come close to the Commission's abandonment criteria. While these are not major trunk lines, they are solid lines with good volume and profit performance. Last year, 26.5 billion—that's billion—revenue ton-miles of traffic moved on the B&O lines. I made this point at the Committee's initial Conrail hearings, and CSX responded by arguing that "it is not how much traffic flows over a line, it is how much income is generated." That agument holds no greater validity. Last year, the B&O lines, in addition to producing $1.1 billion in freight revenue, generated a net profit from operations for CSX Corporation of 5.4 percent.

These lines operate in a region where they already receive vigorous competition from both Conrail and Norfolk Southern, as well as a number of the regional railroads. There is nothing in our assessment of post-merger traffic flows that would so alter their performance as to bridge the normous gap between profitability and the type of sustained losses required to justify an abandonment.

Second, we are obviously not the only ones to have that view. Tim Mellon, owner of the Guilford system, has stated on the record that should CSX make an effort to sell the lines, he would buy them. Bob Claytor of Norfolk Southern made essentially the same statement at the press conference in which the Secretary announced Norfolk Southern's designation. And while these two carriers may be the only ones who have spoken publicly, the location of these lines and the depth of their traffic volume suggests to us at FRA that they would be hotly pursued by other rail carriers should they ever be offered for sale. And that is precisely the reason why they will not be.

Third, there is another and probably more conclusive reason why they would not be subject to abandonment. The B&O employs approximately 12,000 employees on these lines, each of whom would be entitled to the standard labor protection arrangements know as New York Dock and Oregon Short Line. Under these provisions, each employee is, in essence, guaranteed up to six years' full salary following the date on which he loses a job due to line abandonment or merger with another carrier. The cost in labor protection of abandoning the B&O lines would run in the two to three billion dollar range—astronomical figure, far outweighing anything CSX could receive for sale of the assets.

Generally, when a railroad files for abandonment of a line, volumes have fallen on that line to the point where few employees service the business, and labor protection expenses are extremely minimal. Exactly the opposite is the case here, and the financial impact of these labor protection payments is an insurmountable obstacle to the course of action CSX is threatening.

The battle CSX is waging is not one of economic survival. It is, instead, a "Hertz-Avis" battle. At present, CSX is Hertz—the dominant carrier in the East, with 26,000 miles of track to Norfolk Southern's 18,000. It generated $7.9 billion in revenues to NS' $4 billion, services 6,444 stations in comparison to the 3,257 on the NS system. After the merger, NS-Conrail will be slightly larger than CSX—30,000 miles, in comparison to 26,000 miles on the CSX system. But CSX will still be a larger company in revenues, $7.9 billion to $7.5 billion. NS-Conrail will now be Hertz, and CSX will be Avis. But it is highly significant to note that the disparity in their size will be only half as great after the merger as it is today.

I can fully understand why any corporate management would resist an effort by their principal competitor, to become a stronger competitor. It is simply unfortunate that the carrier would threaten the jobs of their employees as a tactic to accomplish its objectives.

These threats are not valid, and pose no public policy reason why Conrail should be denied the financial stability that would result from an NS acquisition, and why consumers should be denied the lower single-line rates it would.

Thank you for taking the time to consider these points, and review this rather lengthy response.

Yours very truly

JOHN H. RILEY, *Administrator.*

Mr. **RILEY**. I would like to just make a wrapup statement on my opening statement if I could.

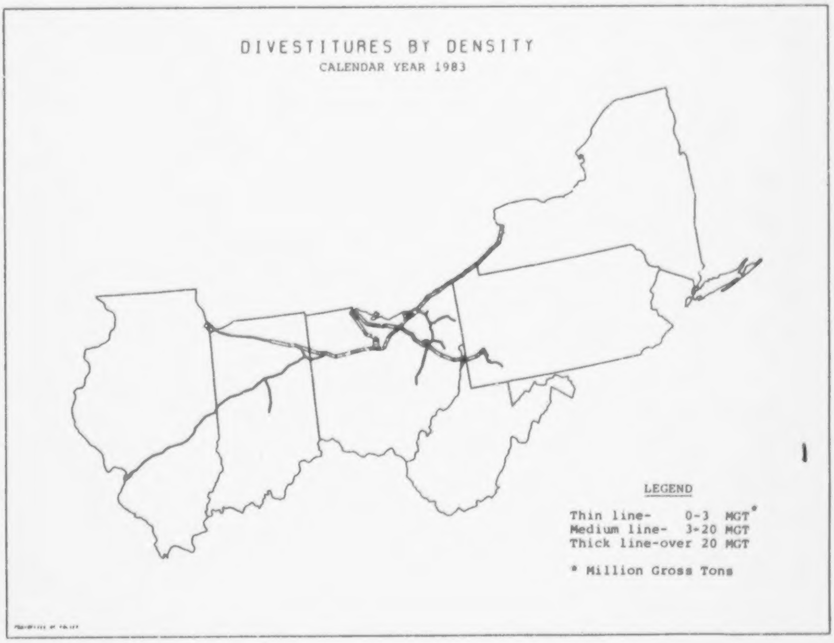
Senator **PRESSLER**. I think the questions will bring that out. We have a red light on. I think you will have a chance here.

I did want to say that I hope that, in addition to this map, that you could provide a density map of traffic of the divested systems for the record, because this is a very attractive looking chart with lines going everywhere, but we really cannot tell the amount of traffic that moves on some of these lines, if very much.

Would that be possible?

Mr. **RILEY**. We would be glad to provide the committee with a density chart. Let me say, we will provide the committee with a chart that reviews those numbers in generalities and we would be glad to meet with you privately and review them in specifics, but we are precluded from providing, as you know, the confidential trade data that we have in specific documents. But we would reveal it all to you.

[The following information was subsequently received for the record:]



DIVESTITURES BY DENSITY

CALENDAR YEAR 1983

Senator **PRESSLER**. Now, you mentioned that the Department of Justice retains the ability to reject Norfolk Southern's chosen competitors. My question is simply whether Norfolk Southern originally selected its own competitor and whether that is usually done in divestiture cases, such as for example Chicago & North Western's bid for Milwaukee?

Mr. Riley. Actually, I would have to say that the Department had as much, if not more, influence in selecting the competitor than the Norfolk Southern did. I can tell you, the Norfolk Southern was told that a divestiture of these lines would make the merger consistent with all antitrust principles.

Senator Pressler. I asked for a yes or no. It is a very simple question. Who made the selection?

Mr. Riley. The Department recommended that they divest to Guilford.

Senator Pressler. Who made the selection?

Mr. Riley. They followed the Department's recommendation.

Senator Pressler. But they specifically originally selected their own competitor, is that not correct?

Mr. Riley. They agreed with our recommendation, yes.

Senator Pressler. They did not have to agree with your recommendation, did they?

Mr. Riley. No, they did not. They could have gone in another direction if they chose to do so.

Senator Pressler. Why is it so hard to say that they selected their competitor if they did?

Mr. Riley. Because I want to make it plain that we also played a role in that. Yes, they selected their competitor, by agreeing with our recommendation.

Senator Pressler. But they might not have agreed with your recommendation. They could have selected another competitor.

Mr. Riley. They could have disagreed. Had they done that, we would have seen it on its merits and made our comments to the Justice Department, which has to make the final decision.

Senator Pressler. Has the Department suggested specific lines to be divested?

Mr. Riley. No. The parties themselves have negotiated on which lines should be divested. Basically, it worked like any other negotiation, as I understand it, although you will have to ask the parties. Guilford requested certain lines, Norfolk offered lines. They negotiated it to the point where Guilford was satisfied that the system would work.

Now Justice will have to determine whether they were right. We believe they were right.

Senator Pressler. Now, was that done in the Chicago & North Western case?

Mr. Riley. I was not at the Department at the time of the Chicago & North Western case.

Senator Pressler. But you know the story of it. Submit it for the record, would you do that? What do you think the answer to that is?

Mr. Riley. Well, the answer is I really do not know, Mr. Rooney, you may know. I do not know.

Mr. Rooney. Senator, perhaps you can be more specific about the question in the Milwaukee case?

Mr. Riley. I think you meant the North Western's original merger with the Great Western?

Senator Pressler. The Chicago's bid for the Milwaukee, was it done in the same way?

Mr. **Riley**. In the Chicago & North Western's bid for Milwaukee, the North Western negotiated and offered a competitive access arrangement where they in fact offered to give the Soo Line access to Kansas City.

So they did in fact recommend the competitive carrier on the spine line in their case. And we supported them, incidentally, in that, although that was rejected in the end by the court.

I do not believe they made any choices in the original Great Western merger.

Senator **Pressler**. I would like to see more, and submit it for the record on that comparison.

Mr. **Riley**. I would be happy to.

[The following information was subsequently received for the record:]

DIVESTITURES IN THE CHICAGO & NORTH WESTERN BID FOR THE MILWAUKEE

In the initial round of applications to the ICC for acquisition of the Milwaukee, the SOO's inconsistent application in response to the CNW's proposal asked for trackage rights over the Spine Line from Twin Cities in Kansas City. Later, when CNW modified its application and revised its offer, it agreed to grant SOO the trackage rights.

Senator **Pressler**. Now, has Guilford made any money in the last 3 years?

Mr. **Riley**. Guilford is in fact profitable this year. Guilford has existed for 18 months in its present configuration.

Senator **Pressler**. Over the last 3 years, what has been their record?

Mr. **Riley**. Guilford has existed for 18 months. In the first year of their existence, the railroad had suffered a slight loss. This year it made a profit. When Guilford was formed approximately 18 months agp by the juncture of the Boston & Maine, the Maine Central, and the Delaware & Hudson, two of those railroads were in bankruptcy at the time it was formed.

Senator **Pressler**. Those are the lines it was combined from. What about the combined lines?

Mr. **Riley**. The combined lines are profitable and all three railroads are on a positive cash flow.

Senator **Pressler**. I know that some of this may have been covered to some extent. But during my brief time—and I will have some more questions—how much has the Federal Government invested in Conrail to this point?

Mr. **Riley**. A total of $7.7 billion has been spent on the Northeast rail system. I will be honest and tell the chairman that there can be debates on how one counts that, but that includes Conrail, Amtrak, the commuter services, and operating subsidies.

About $3.2 billion of that can be traced one way or another to Conrail as we know it today.

Senator **Pressler**. Well, you have heard my concerns about traffic diversions being ignored or at least not fully considered in the competitiveness and divestiture issue as it relates to the Midwest regional carriers. Do you agree, and can or should the traffic diversion calculations be added into the picture?

Mr. **Riley**. Traffic diversion calculations have been a part of our analysis from the beginning, because we are concerned about what the map looks like after the divestiture is completed. And I realize that the chairman was out of the room for a second when I went over this. But our analysis indicates a probable diversion—I want to emphasize that—of 2 percent or less on the five Midwestern carriers.

And I say probable because one can construct a best case scenario where it goes to zero and one can construct any number of worst-case scenarios if you want to do that. We have made our best judgment.

But let me also say that where diversions occur they occur largely because consumers are offered better prices or better service, and that is not an evil. It puts pressure on the other carrier to respond, and the diversions can often be avoided by price changes or service changes by the other carrier. The consumer does gain a net benefit. In fact, the last time I was at the committee I think I quoted the president of CSX to say that the diversions are a tangible quantification of proconsumer impact.

Now, obviously at an outer limit that damages a carrier and you have to consider it. None of the numbers here reach that limit.

Senator PRESSLER. Senator Ford.

Senator FORD. I have one major coal haul problem, Mr. Riley, that bothers me a great deal, and there are a lot of rumors, which I think is one of the problems that we have run into as it relates to this transaction. And I want to find the answers and get them in writing.

Appalachia is a very important area to my State as it relates to coal. Coal is very important to the railroads. We are beginning to see some reduction in rates in the last few weeks, and I am delighted to see that. And the rumors are out that if this merger takes place there will be no coal shipped north out of Appalachia, that is, Kentucky.

And I would like to have your opinion on that.

Mr. ROONEY. Senator, I would like to deal with that one, if I may.

Senator FORD. Well, just speak up.

Mr. ROONEY. Senator, there are two points to be made here and I will make them in generalities here today and I would be delighted to come and visit with you and provide you the detailed information.

Senator FORD. You have got a deal.

Mr. ROONEY. First off, the amalgamation of these large eastern systems has produced the kinds of megasystems which will allow them to deliver a very large amount of coal on their own tracks. And as a consequence, when I look at Kentucky and I look at the carload movements of coal north out of Kentucky—you and I both know that it flows up through the eastern side of the State up on the Chessie system and the old L&N through Cincinnati—that those people have acquired northern branches when they merged the Seaboard system and the Chessie and when they merged the Norfolk Southern and the Southern and so on.

When they put those systems together, they bought themselves the ability to deliver a lot of that coal on their own tracks. So whereas years ago there was this gateway concept, in real terms at places like Cincinnati that has been very much diminished as a factor of deliverability of Kentucky coal at this point in time.

That is not to say there are not some movements where these people have to cooperate to get the coal to the end consumer. There are. But they are very much limited compared to the point in time, say 10 years ago, when these systems had not been amalgamated.

As I said, Senator, I am somewhat circumscribed from answering your question in great specifics, because a number of the items that I would have to mention would be proprietary information. But in general terms, that is the answer, and I would be happy to come to your office and lay that out in specifics.

Senator FORD. We will get together and work out a time where you can visit with me and we will talk about this at great length. It is difficult for me to protect my constituency when the facts are difficult to come by and rumors are rampant, and so I am trying to find out the fact.

Let me ask you this. Jobs have become a red flag, even those on Norfolk Southern—when you have, well, the Cincinnati gateway, which I have some knowledge about, where you have I guess Norfolk Southern and Conrail both in that vicinity.

You know and I know both will not remain as they are if this merger goes through. That would be my judgment. So what does it mean, then, if you have the merger and you have a Conrail facility and a Norfolk Southern facility in the Cincinnati area? What happens to the jobs?

Mr. ROONEY. Senator, there are some very specific answers to that. We are talking now about Cincinnati. In general terms again, there will be a reconfiguration of physical facilities in Cincinnati, but there will not be any wholesale abandonments or changes, to the best of my knowledge. I have examined that particular point in some detail.

Senator FORD. So the employees of the Norfolk Southern and Conrail can feel comfortable that their jobs will be retained?

Mr. ROONEY. Yes, Senator. I cannot cite you the specifics right now, but in general terms I would say that is a good assumption.

Mr. RILEY. If I could make two comments on that. One, the Norfolk I know is fairly detailed in its planning on employment and I think they are in a position to share that with you. I asked Chris to respond to the particular. Let me respond to the aggregate, and I will also answer your question about the New York gateway that you asked earlier.

This merger would affect approximately 1,800 positions. However, 600 of those positions would go over to the Guilford and the P&LE as new hires. So it is a net impact of about 1,200 systemwide.

The net annual attrition of the carriers is about 4,800 to 4,900 a year, so it is well within their average attrition of the two carriers combined. However, any employee whose position was not covered by attrition gets something called New York Dock, and that is what the labor people are talking about, New York Dock.

Senator FORD. That is my fault.

Mr. RILEY. No, believe me, it is not something that is talked about in the stands at ballgames. It is very esoteric to the industry.

New York Dock is an agreement whereby a railroad agrees that any employee whose job is affected as a result of a merger gets 6 years full salary after they leave employment, which is better than

I have. And I do not put it down. It is something they fought for many years to win.

Norfolk Southern has agreed to give New York Dock to any employee whose job is affected by this merger. However, the employee numbers appear to be well within the annual attrition of the carriers, although you cannot always assume that attrition and job change will match in every instance.

Senator **Ford**. Mr. Chairman, I apologize for going beyond the red light. But as the chairman said a few moments ago, no one pays attention to it here anyhow.

Mr. **Riley**. My time is yours. I will stay as long as you all would like me to.

Senator **Ford**. Well, we cannot stay that long.

There is the rumor—and we heard this morning Mr. Conlon indirectly talked about how many employees might be jeopardized of their 11,000 employees—among other railroads in my State, and I suspect the State of Tennessee and all through that area, about how many jobs are going to be lost and how many shops are going to be closed as a result of the merger.

We have had a purchase and a merger in my State—L&N to Seaboard to Chessie—and we have lost thousands of jobs in the last 5 years from the purchase and the merger. And so those employees are nervous who are still there. They need assurance.

Before this bill gets out of this committee, I am going to try to give them some assurance locked in statutory language. But can you tell me what other railroad employees can expect as it relates to this merger if it is approved by Congress? And I think it is going to be a long, long time before approval.

Mr. **Riley**. Maybe I can answer it best this way. I have given you the aggregate figures that come from this merger. As you know, Conrail has estimated themselves that a stand-alone Conrail would involve on the Conrail system job losses in the 4,000 range over the next 4 years.

The advantage—and looking at the other competing carriers, when you are talking diversions in the 2 percent or less range, you are not talking employment impact. Now, over the last 30 years the railroads have lost markets. Employment in this industry has fallen from 4.5 million to about 500,000.

That has been the trend. Some of it has come with mergers, some of it has come from other reasons. But the bottom line to it is this: If we have learned nothing else from the collapse of the Northeastern railroads and the Midwestern railroads in my State—and the Senator has been through it in his State, I know—we have learned that financial strength is the best long-term guarantee of jobs and service, and that financial weakness is nearly an absolute guarantee that jobs and service will be lost.

That was heavily on our mind when the Secretary made the selection, and it is our belief that there is no merger, there is no form of sale, that will leave Conrail a financially stronger entity than a merger with the Norfolk Southern.

And that was driven home in dramatic detail 4 days ago when the USRA released its report on Conrail's viability. If you look very carefully at the chart on page 43 of the report, what it tells you—and I think we would all agree, as the Senator said, that there is no probability that this deal could close before the end of this year at the earliest—out the 3 years, 1986, 1987, 1988, that Conrail has done estimations in, they project a total net cash flow for Conrail of only $118 million.

To put that in perspective, to pay the dividends under the management plan would require $126 million a year. Moreover, of that $118 million cash flow, $100 million comes from the sale of Conrail property. The rest comes from interest on Conrail's cash.

What that report tells us is that, while Conrail can stand alone in the short run, it can stand alone very marginally, with no net cash flow, so long as it does not have to pay any dividends. It is precisely that concern that led us to the Norfolk Southern merger as a way to protect Conrail's employment and service in the long run.

Now, in the long run the future of this industry is not in transcontinental mergers. I think the Conrail sale showed that. The future of this industry is in the six big regionals each acquiring major truck subsidiaries and raiding each other's territories with trucks. And you can see it happening today.

Conrail of all the six is the most susceptible to truck raiding because its distances are shorter, its businesses are concentrated, and they produce the kinds of commodities that can move by truck.

Over the short term, Conrail can stand alone marginally, and we do not want a marginal railroad. In fact, Chairman Crane said this morning in his testimony before the Appropriations Committee that Conrail had lost money in January and was already $30 million plus in revenues under budget this year.

These are the kinds of things that concern us and why we are seeking to stabilize employment with a strong purchaser.

Senator EXON. Mr. Chairman, thank you.

I thank you for coming here. As I said earlier, I have not made up my mind on this, and we have had relatively few inquiries from Nebraska about this. That is why I mentioned earlier, I will be influenced to some degree at least by what the other railroads in the area think of this in addition to the Chicago & North Western.

I would very much appreciate you or your staff analyzing the letter that I received from ConAgra—which is one of our largest food handlers and processors, one of the largest in the world—and their frankly stated concerns about this. And I will send this letter over to you. I do not ask you to answer it now, but if you would write me on it I would appreciate it very much.

Mr. RILEY. I would be very happy to. I would also be very happy to meet with ConAgra if you would like.

Senator EXON. I would be very happy to have you meet with them, because, you know, this is on such a fast track that if there are legitimate objections that can be resolved, then this is the time to raise them, it seems to me, rather than after the fact when the sale is completed, and when you worry about whether you overlooked something. And if we overlook something, it is going to be primarily as a result of a substantial number of Nebraska's interests not having come forth and shown a concern.

I have just one question. I will be interested in the density map that you are going to send us. I have heard rumors also that this is not a situation where the new owner would have what would be considered normal competition from the other lines. Again, that is a judgment call, and that is why I try to attend as many of these hearings as I can—to get a feel for that.

But let me ask you this question. Why are we on such a fast track? I come back to that. As I understand it, the Justice Department has not yet completed their evaluation of this whole proposition. It seems a little strange to me that we are rushing ahead, and the Secretary of Transportation is actively pursuing a sale, which might be a good one, before the Justice Department total findings have been completed and, as far as I know, presented to us.

Is that unusual, or what is the reason for the fast truck?

Mr. **Riley**. Let me say that we expect Congress to take whatever time it needs to analyze this.

Senator **Exon**. Now, having said that, you know that this is on a fast track for the Administration, do you not, and a fast track here in the United States Senate?

Mr. **Riley**. Let me tell you why we think the Congress should move on it as quickly as you deem prudent. Now, on the Justice end of it, what the Justice Department has done is to prescribe the solution. They have defined that. What Norfolk and Guilford are doing is to attempt to implement that solution.

The Justice Department's analysis is not unfinished. They have laid out what has to be done. There are two issues: Has it been done and is the traffic viable? We know the carrier, we know the prescription. I think we are in a position to analyze that, as they are. And frankly, we are going to try to help the committee by pushing those parties along to get their written agreement over to Justice.

What do we stand to lose by moving slower than we have to? And I am intentionally being open on that because each of us has to decide in our own minds the time that we need to analyze this, just as we did when we were analyzing the bids.

Right now the States lose between $26 million and $32 million a year in taxes for every year that we own Conrail. In addition, we pay all of Conrail's labor protection, running between $32 million and $77 million a year. That will continue.

In addition, we forego the use of the $1.2 billion, $1.3 billion, whatever it ends up being, final purchase price.

In addition, Conrail is right now today using the $2.5 billion in tax benefits that Norfolk would yield back to shelter its income. Conrail is a Federal taxpayer today. They are just not a State taxpayer. And the number of tax benefits being yielded back—it was $2.4 billion last time I came here—has dropped to $1.9 billion, because Conrail has used about $500 million of them to shelter their income.

And there is also a certainty and uncertainty factor, as you know. In my part of the country—in our part of the country, I guess—grain elevators decide what lines to locate on, businesses decide their long-term shipping plans, based on the configuration of their rail system and their ability to enter long-term contracts. Uncertainty does not help Conrail; it hurts it.

Now, those are the reasons why we think the committee should move as fast as you deem prudent. In the end you have to be the judge of that, as you know, and I am sure you are. We have no power to influence you.

So we are going to, from our perspective, urge you again to move as quickly as you deem prudent. But we cannot define prudence. You are the only ones that can.

Senator **Exon**. Well, thank you very much for your candor. And once again, I would emphasize that I have not made any firm decision on this. And you have given some good reasons why we should move as speedily as possible. I guess you could say that is true to some degree or another whether I am selling a pencil or a railroad. There are reasons to complete the sale as soon as possible for both parties.

Now, having said that, I would simply say that there are other parties involved in this besides the Government, who is the owner selling it, and the company who has tendered what you consider the best offer. There are other consumers out there, and there are long-term implications that this sale could have.

And that is why I am trying to keep an open mind, and am one who is still seeking to dot all the i's and cross all the t's that we can on this before at least I would ever give it my approval.

Thank you.

Mr. **Riley**. Given the choice, Senator, I would clearly choose pencils over railroads in the future if I have to be a seller, I can assure you.

Senator **Pressler**. What is the exact status of the proposed divestiture? Has it been approved by the Department of Justice?

Mr. **Riley**. No, it has not. Senator, there is an agreement in principle. There are two agreements in principle, one between the Norfolk Southern and the Guilford, one between the Norfolk Southern and the Pittsburgh & Lake Erie.

They are agreements in principle. They are being reduced to writing and they will be submitted to the Justice Department. Let me distinguish between the two, if it would be helpful. The Guilford is the new entrant. They are the prime competitive carrier.

The reason we have suggested that Norfolk make divestitures to the Pittsburgh & Lake Erie is to prevent a competitive problem from arising in the future. Right now the Pittsburgh & Lake Erie is surrounded by Conrail, serves a 556-mile area, but does not have a good chance for long-term survival because it has no friendly connections and it cannot reach its ultimate destinations.

What we have done with these divestitures is break the P&LE out of its isolation, give it carriage to Toledo, to Cleveland, to Steubenville, improve its access to Canton and Massillon, so it can survive over the long run.

It is our view that if Conrail stands alone it would mean, in addition to the loss of 1,000 jobs, the loss of competition in nearly a 500-mile area. The divestitures to P&LE are designed to prevent that future problem from arising.

Senator **Pressler**. Could you comment on my concern about the ripple effect of a Norfolk Southern-Conrail merger on branch lines in States such as South Dakota? Specifically, assuming traffic is diverted from a Midwestern carrier's main line, Chicago & North Western for instance, could it affect the branchlines in my State?

Mr. **Riley**. Let me answer that in two ways, Senator. As you know, I got my start in this business working with shippers on light density branch lines in southern Minnesota as you were working in South Dakota in the Milwaukee transfer.

Diversions in the 2-percent range are not likely to have an effect on branch lines. South Dakota moves east less than 1,000 carloads into this region. The impact of my State, Minnesota, is not much greater than that.

Where it could affect branch lines is on the Conrail system, because if I learned nothing else in my experience in Rosemont and Austin and Jackson, I learned that when a railroad suffers financial weakness the first thing that gets starved is the branch line, because, like any rational manager, the managers of that railroad put their investment in the profitable main lines and they bleed the branch lines.

A financially strong railroad gives the branch lines a chance to live. A financially weak railroad makes branch lines the biggest losers, and that is another reason why we wanted financial strength for Conrail.

In your State and in my State, I really do not see, with diversions of the magnitude we are talking about, particularly diversions coming out of the Kansas City area, that it has much effect on our branch lines, because the traffic coming off these branch lines is not being diverted to anyone.

Moreover, that is originating traffic. That traffic is going to go somewhere. As long as it is there, it is going to flow off the branch line.

Senator **Pressler**. Relative to the Grand Trunk and comparable railroads, are the Guilford and the P&LE in a poor financial condition? Are they as viable a competitor as would be the Grand Trunk and others? Can they afford to rehabilitate and maintain the acquired lines?

Mr. **Riley**. Taking those questions in the reverse order, there is no question that they can afford to purchase and rehabilitate. I an informed that the Pittsburgh & Lake Erie has lined up its financing already. On the Guilford system, Tim Mellon came to the table bidding for Conrail with over $1.1 billion, so I know what their capitalization is.

On the rehabilitation, the great majority of this system—the Chicago to Buffalo run, the Wheeling and Lake Erie lines—do not require any rehabilitation to speak of. They are in excellent shape.

The one area that requires some rehabilitation is part of the line from Delphos to St. Louis. It is not structural rehabilitation. The line is 115 pound mainline steel. All that it needs is conventional grading and tie replacement, and that is well within the present financial capacity of the Guilford system. And in fact, they will have to agree to do that with their own money as a condition of the deal or we will object, and in fact they have so agreed.

Now, the Guilford is unquestionably financially the strongest and best capitalized of those railroads. The only one that presently is financially weak is the Pittsburgh & Lake Erie. Bear this in mind, however, the Pittsburgh & Lake Erie—well, I think Paul McGrath said it better than I can say it.

He said that a railroad's strength is a function of location and interconnections. The lines that we are divesting to Pittsburgh & Lake Erie are the old Nickel Plate lines. In fact, they are going to call it the Nickel Plate Railroad.

The Nickel Plate lines were among the most profitable lines in this country right through 1976. In fact, the Wheeling & Lake Erie made money every year of the Great Depression, which made them famous. In 1976 when the Penn Central went down and Conrail was formed, it severed the Eastern connections for those lines.

What we have done is to recreate the Eastern connections for those lines. The Guilford system is the lost Eastern connection. We have reassembled a system that has a traditional record of profitable operation and connected it to all of the Western railroads, where it can access half the volume in the country. We are confident that that system could work in the hands of any of those three railroads. The Guilford is financially the strongest of the three.

Senator **Pressler**. Senator Ford.

Senator **Ford**. Mr. Riley, I want to get back to a couple of points you made. You talked about gateways, and that we have three today and still would have three tomorrow regardless. One thing that struck me as strange is that if you have two railroads in a gateway today and tomorrow there is one owner of two railroads, it appears to me that railroad that owns the other one would have some say over what the other one does.

Mr. **Riley**. Exactly right.

Senator **Ford**. That somewhat limits the number, then. Instead of, having four railroads in a gateway, you would have two railroads owned by the same carrier. So these two would begin to control, and this is what I think may be a fear of some other railroads. Can you lessen my fear?

Mr. **Riley**. I am not going to try, because I think you are absolutely right. And that is why the divestitures were made. Let me illustrate in Chicago. Right now you have got four railroads in the Chicago gateway. You have got Norfolk Southern, you have got CSX, you have got Conrail, and you have got Grand Trunk.

The merger between Conrail and Norfolk Southern would lower that to three. Now, some would view that still as being very competitive. I will be honest with you, Mr. Chairman. I would.

But the Justice Department took the position that there could not be a reduction. So that is why we have now introduced the Guilford Nickel Plate trunkline system into Chicago, so it goes back to four. You have stated exactly what the concern of the Justice Department was.

You see, what they determined was that East of Buffalo and Pittsburgh it was an end to end merger. There was no line overlap, no gateway problem. West of Buffalo-Pittsburgh, there were roughly a dozen areas where what you described would happen, and they made Norfolk Southern bring a competitive carrier into each of those areas, and now they are left to judge if Norfolk Southern did it right.

Senator **Ford**. I still have a hard time understanding the gateway concept.

Mr. **Riley**. So do railroad people.

Senator FORD. Railroads have been good and bad, I guess like everything else. But you have four railroads. How would I, being another railroad wanting to get in there, choose which one of those to deal with, given, say, that they all go to the same place—I get into Chicago and I want to go to Milwaukee, and they all go to Milwaukee?

Do I just take the lowest bidder, the lowest tariff?

Mr. RILEY. What you do is you look at who has the lowest cost, who has the best service. And you would also bid them off against one another. That is exactly what you do, you bid them off.

You see, the point I made at the beginning of my opening statement—and I hope I made this clear, because it was really without a lot of preparation on that part of it—right now in Chicago, a Midwestern shipper has one way to get single line service to the Northeast and that is Conrail.

You see, after this merger he will have two. He will have Conrail and Guilford. So he could bid the two of them off against one another and go with the low-cost carrier. That is how it works.

Senator FORD. You are taking a line from Conrail and giving it to Guilford, is that it?

Mr. RILEY. What we are doing is selling rail from Norfolk Southern basically, plus about 400 miles of Conrail, to Guilford. That is what we are doing.

Senator FORD. It seems to me that this is a business transaction.

Mr. RILEY. Yes.

Senator FORD. And those who are going to operate the railroad are somewhat at a loss to make a decision as to good business because you are making them too large—a monopoly or whatever. So they are going to have to divest.

It seems to me that a recommendation, as long as it meets a guideline, ought to be acceptable, rather than the Justice Department having the final say as to the antitrust or monopoly problem. They make a decision there, not necessarily based on good business policy in my opinion. They are making a decision based on law, and so therefore you are forcing a railroad to divest of certain lines.

And there have also been rumors that if this goes through, other railroads are going to sell their smaller lines off, too. I wonder if the Justice Department is going to make a decision as to whether they can sell or not or whom they sell to.

It bothers me a little bit, and I am not saying that the Justice Department is wrong or that we should not have it in this. But do they have enough knowledge of the sale of the line, as to whether it is good business for the railroad, whether there is proper coverage for the employees, and those sorts of issues?

How is that decision made?

Mr. RILEY. Well, the Justice Department begins with determining what meets the antitrust competitive guidelines. Now, once they have done that, rather than attempt to make that decision for the parties, they told the parties: Now, you have to make a business decision. Norfolk Southern, you have got to decide whether with the divestiture of these lines this is still a good enough business deal for you. If it is not, you are going to walk away.

And in fact, I will tell you, they went back and mulled on the report for 2 or 3 days after it came back in January before they notified us they would accept it. Then, when they threw the lines open for divestiture the bidding railroad, Guilford, had to make a business decision on whether it could compete effectively on the lines that were being offered. If it did not, they would not buy them. Mr. Mellon has not lost much money on any of these deals. He has done very well with them.

My point is, Senator, what you have is a merging of business reality and legal principle. The antitrust laws themselves are based on business principles, how to keep the consumer in a price-protected position. When Justice defines what the antitrust laws require, then on the other side of it the railroads themselves have to make the business decision on whether they will live with it.

Senator FORD. But there is something about that statement that bothers me just a hair. A moment ago you said we made them take Guilford, I believe, into Chicago. Now, if we made them take it, is that an antitrust decision? You know, something about that, Mr. Riley, just does not ring like an expensive piece of crystal.

Mr. RILEY. Well, I cannot come up with an analogy to match that. I am using the word "we" a bit too liberally. We is not just we.

But the way the process works, again on Chicago, the Justice Department determines that if you lose a carrier in Chicago you have had an impermissible reduction in competition. So Justice then says you must reintroduce a carrier to Chicago to make this deal acceptable to us. The Norfolk then has the right to sell that to anybody they want, subject to Justice's approval.

Now we at the Department, being I suppose a little bit of neither fish nor fowl, we look at it from a business and long-term rail structure view. We recommend to the Norfolk Southern that they consider the Guilford as a purchaser, but we do not take away their right to sell it to someone else. They do in fact make the sale to the Guilford.

They have made a business judgment that their deal does not lose its value by virtue of the divestitures. Guilford has made a business judgment that they can make the lines work.

Anyone who comments to the Justice Department or this committee on that deal will express their business judgment on how the deal affects them. It is really an amalgam of all of it. Antitrust is not the world's simplest process.

Senator FORD. I understand that a little bit. But if I am going to sell—you know, you say, you have too much, and you have to sell—I am not going to sell my best; I am going to sell the one that is not going to give me the greatest competition. You know, that is just common sense. Of course, those are two words we do not hear much around here, but nevertheless I would not sell off the one that is going to give me the greatest competition. I would sell off the one that is going to be the least competitive.

Mr. RILEY. I am sure that I or Norfolk Southern might have done the same thing if they did not have the Justice Department looking back over their shoulder. And that is why the Justice Department refused to relinquish jurisdiction of this case. The Justice Department has to make a final decision on whether the divestitures were made in a way that preserves long-term viability and do in fact open the competitive gateways.

Senator **Ford**. I am still going back to the fact—and I do not fault Justice—that they are not educated to run a railroad. And if you leave it up to the principals to divest, they are going to divest the one that is the least competitive and try to convince Justice that it is the right thing to do, in my opinion.

And my red light is on, and I apologize for that. But it bothers me a great deal, John.

Mr. **Riley**. There are three fallbacks on that. One, as you know, the Justice Department brings in consultants from just about every discipline to look at these same issues.

Second, the Department of Transportation is a railroad agency. We make those decisions and we make our recommendations. Every other railroad has had, does have, and will continue to have the ability to state its views to the Justice Department and to these Congressional committees.

And so will consumers. The first time we went through this—I am using "we" broadly meaning the Federal Government—that Justice went through this analysis, they interviewed over 700 shippers and they analyzed the waybill sample. They had access to 100 percent of Conrail and Norfolk Southern's waybill movements, so they knew the true economics of each line.

But it is a good question and it is exactly the kind of issue that they have to deal with.

Senator **Pressler**. I want to compliment Senator Ford on his point on the gateways. That is something that I very much agree with.

Let me also say that the expensive piece of crystal analogy is a good one in this area, because it has bothered me. If a proposed divestiture supposedly addresses all the competitive problems associated with the merger, then why does the legislation have to extend antitrust immunity to the merger?

Mr. **Riley**. Here is the reason, and this is—let me spell this out for you, because it is an important question. When Congress passed the NERSA Act in 1981, it made a decision to exempt this proceeding from ICC review and it did that for two reasons. One was time, but more important was the recognition that this was a sale. It was not a conventional merger, and it should not be judged by the normal merger criteria.

Now, that gave rise to a problem. The ICC, under its statute, grants antitrust immunity to any transaction that it approves, and the reason for that is to prevent competitors from tying up the deal for 10, 20 years with litigation. The ICC has that power.

Recognizing that by exempting the transaction from ICC jurisdiction it had created that problem, Congress also wrote into the NERSA Act language that said the sale, once approved by Congress, was immune from judicial challenge. It was designed to provide the same kind of antitrust immunity that the ICC does. We have followed through on that principle in our implementing legislation for precisely the same reasons. That is the origin of that provision.

But the Secretary took a second position. She took the position that she was not going to attempt to make antitrust decisions, that she was going to, regardless of the statute, refer this to the Justice Department to make final judgments.

My third, final, and most important point is this. I know this committee has closely followed all previous rail mergers, and you know that the Norfolk Southern won no benefit when it was turned over to the Justice Department rather than the ICC. The Justice Department has generally taken a very strict position in its advice to the ICC. The ICC has generally taken a position more favorable to mergers than Justice has taken.

This is the one merger in modern times where the railroad did not have the friendlier confines of the ICC and was absolutely at the mercy of the Justice Department, and many theories that Justice has argued and at times had rejected in the past the Norfolk had no choice but to accept.

And that is why Bob Claytor says this was, in addition to the very proper inspection that you are giving it, the most inspected merger, with the most hurdles of any merger in railroad history. I personally believe he is right.

Senator PRESSLER. Now, assuming the divestitures go through as we know them today, what happens if either or both the Guilford or the P&LE go broke? Will the Norfolk Southern still enjoy antitrust immunity, and should it?

Mr. RILEY. All right. The answer to that is that in structuring any merger, in deciding whether to let Conrail stand alone, to make a divestiture to P&LE or to any other carrier, we have to make a judgment on whether that carrier has long-term viability. The judgment on long-term financial viability is an absolute prerequisite to the Justice Department's approval.

Moreover, let us assume that at some point the railroad went into liquidation—not into liquidation, but into bankruptcy—and its stock was put up for sale. If the Norfolk Southern attempted to acquire that line, there would obviously be mortal objections from the Justice Department.

I think Chris also had a comment on that. I do not know what it is, but I do not want to preempt it.

Mr. ROONEY. Senator, I think it is important to point out here that there would also be a challenge at the ICC if they attempted to acquire that line, because at that point in time it would be out from under this umbrella of exemption that attaches only to the sale, the DOJ divestiture program, and the coordination of the two carriers.

It is directly analogous to that amount of immunity granted by the ICC to a merger which it approves with conditions.

Senator PRESSLER. OK, I have no further questions. Senator Gorton may have a question for the record.

Let me ask one final question. Is your testimony today the position of the Department of Transportation or your own position?

Mr. RILEY. To the best of my understanding, it is the position of the Federal Railroad Administration, which I believe will be the Department's position. And if there are any exceptions in reviewing the transcript, I will be glad to point that out to the chair. But I do not see any difference.

Senator PRESSLER. You are the DOT here today?

Mr. RILEY. I really feel a sense of power.

My second thought is, I do not know whether that is good or bad. But yes, I am the DOT today.

In addition to thanking the committee for your time and some very good questions, I would make two additional points. One is that we are available to meet with you at any time on any issue.

The second point is this. Conrail made an argument in their testimony before Judiciary—which I was unable to attend because I was testifying in the House on our budget, which is very close to my heart—3 days ago to the effect that in their view, and I notice they make the same point today, in their view the provisions which require the opening of gateways, require reciprocal switching access, and require arbitration for consumers in this divestiture are outside the spirit of the Staggers Act.

And I just want to tell the committee that if that is their objection, they have got me. But we will stand on it, because what we have done is to ensure that consumers in those cities have access, the same access to rail service that they had before. We have preserved reciprocal switching, we have preserved the gateways, and we believe that is important in the context of this transaction, which is a specialized transaction having nothing to do with the generalized principles of the Staggers Act. And I believe that if you gave shippers a choice they would agree with my position.

I also want to make it plain that the Norfolk Southern has supported and agreed to abide by the AAR agreement on gateways and joint routings. I do not know that Conrail has taken that position as yet.

I thank the Chair. It has been a pleasure to be here.

Senator **Pressler**. Now we will call forward Mr. Watts and Mr. Wilson. Mr. Watts, the vice president for corporate planning, Norfolk Southern Corp.; and Mr. Bruce Wilson of the Consolidated Rail Corp.

We will place your statements in the record. We ask you to summarize. We will hear from Mr. Watts first if that is all right.

STATEMENTS OF D. HENRY WATTS, VICE PRESIDENT, CORPORATE PLANNING, NORFOLK SOUTHERN CORP., ACCOMPANIED BY JOHN McMICHAEL, CONSULTANT, NORFOLK SOUTHERN CORP.; AND BRUCE WILSON, VICE PRESIDENT, LAW, CONSOLIDATED RAIL CORP.

Mr. **Watts**. Thank you, Mr. Chairman. We are happy to be here today to address the question of the impact of a Norfolk Southern acquisition of Conrail on Midwestern railroads.

My name is Henry Watts. I am vice president—corporate development for Norfolk Southern Corp. Norfolk Southern's study of Conrail was performed under my supervision. With me today is John R. McMichael, retired vice president for pricing of Norfolk Southern, who directed the traffic diversion aspect of that study and is generally credited with developing the model on which current railroad railroad industry traffic diversion studies are uniformly based.

The traffic study was performed to assist our management in making a decision on Conrail. It was not performed with an eye toward these hearings or any other public use. Its conclusions include our best judgment of the maximum impact of the acquisition on Midwestern carriers.

I would like to very briefly summarize the main conclusions of our traffic study. Because a combined system can offer more single system hauls and often more efficient routing than two separate systems, it will attract new business from other railroads, trucks, and other transportation modes.

Our study quantifies a portion of the gains from other railroads. The traffic diversion study was completed early in 1984. It demonstrated that a combined Norfolk Southern-Conrail could divert rail traffic to the unified system on the order of $165 million of freight revenue from all other railroads.

Additionally, should Norfolk Southern adopt Conrail's aggressive policies to obtain its long haul everywhere possible, another $69 million of freight revenue could be diverted. There is attached to my statement a summarizing of these findings.

[The attachment follows:]

TRAFFIC DIVERSION STUDY [1]—GROSS REVENUE GAINS OR (LOSSES) TO NS–CR

[In millions of dollars]

Affected carrier	NS–CR consolidation gains	Net routing gains	Net gain of (loss)
CSX	$40.4	[2] $2.5	$42.9
CNW	41.8	3.6	45.4
UPMP	18.9	21.5	40.4
ATSF	18.0	(3.9)	14.1
BN	13.7	15.7	29.4
ICG	10.3	5.8	16.1
Guilford	7.8	4.2	12.0
GTW	6.5	9.3	15.8
Milwaukee	7.0	5.4	12.4
KCS	3.7	4.0	7.7
Other	(3.0)	0.7	(2.3)
NS–CR	165.1	68.8	233.9

[1] Before concessions to small eastern carriers (including GTW) divestiture of lines required by Department of Justice. AAR/NITL Agreement, and offers to Midwestern railroads.

[2] Net of retaliatory route closings.

Mr. **Watts**. Several events have occurred since May 1984 which will in the real world reduce the early 1984 estimates. First, Norfolk Southern voluntarily and publicly committed itself to maintain current routes and reestablish critical routes closed by Conrail against the smaller Eastern rail carriers in Conrail territory, including the Grand Trunk Western. We estimate revenue losses of $38 million from this commitment.

Second, Norfolk Southern has agreed to divest properties necessary to maintain the same number of rail competitors in certain markets, as required by the Department of Justice. Approximately $105 million of traffic will be lost to the new carriers, who, I might add, will also gain traffic from other railroads, including Canadian railroads, and should generate new traffic from other transportation modes.

Third, arising from discussions with certain connecting carriers, we have offered concessions to the ICG, to the C&NW, and to the Kansas City Southern. NS continues to be responsive to the concerns of these carriers, which are outside the concerns expressed by the Department of Justice. We are prepared to negotiate further and we consider the negotiations to still be open. We think the offers made to the ICG, to the C&NW, and to the Kansas City Southern will significantly reduce the estimate of diversions developed in the May 1984 study.

Fourth and finally, Norfolk Southern supports and has agreed to be bound by the proposed Association of American Railroads and National Industrial Transportation League standards that govern the cancellation of through routes and joint rates. We have not estimated the dollar effect of this commitment, but it will substantially reduce the diversion gains in the May 1984 study, which were based on an assumption that we would optimize Norfolk Southern-Conrail routing opportunities.

While these poststudy commitments do not produce impacts which are altogether additive on Norfolk Southern, because there is some overlap, I think it is important to note that they do very much reduce the diversion gains to Norfolk Southern-Conrail and tend to make the vast preponderance of remaining gains a simple matter of shipper preference for the better or cheaper service made possible by the combination.

Mr. Chairman, Mr. McMichael and I will be glad to answer any questions you may have.

Senator PRESSLER. I will now call upon Mr. Wilson for his statement.

Mr. WILSON. Thank you, Mr. Chairman.

My name is Bruce Wilson. I am Conrail's chief legal officer, and from 1971 to 1976 I had the privilege to serve as the Deputy Assistant Attorney General in the Antitrust Division.

Let me first make one point in answer to Mr. Riley. He said that this has been the most examined railroad merger in modern times. While that may be true, let me point out one big difference between this merger and any other railroad merger which has been considered by the ICC, or indeed, any other merger between large industrial corporations which has been considered in the courts of the United States.

The consideration which has been given to this merger has largely been done within the executive branch and not on the public record. We heard, for example, Mr. Riley testify today that there will be diversions of 2 percent. We heard Mr. Conlon state that the diversions with respect to his railroad would really be substantial. I think I heard him say 47 percent of their gross ton miles.

Somewhere in between those two extremes the truth probably lies. But to find the truth in the ordinary merger case what we have is a public proceeding on the record, with rights of discovery, with rights of cross-examination, and a decision by a judicial or quasi-judicial body.

Senator PRESSLER. That is an excellent point, because, like when they say that they advised them to choose their competitor, on what basis did they advise them? Nobody knows.

Mr. WILSON. We do not know that, Senator. And absent some kind of a public record proceeding, I do not think we can know that.

We do not really know, for example, what procedure the Justice Department went through in its analysis. We know that it looked at head-to-head competition. There are other kinds of competition, like source competition and what we have called national market competition, where we compete with our friends at the Norfolk Southern because our customers, people located on our lines, compete in end markets somewhere else.

We have reduced rates on interplant shipments for Bethlehem Steel, for example, to keep Bethlehem competitive in other markets outside of our territory where perhaps Bethlehem is competing with mills which may well be located on the Norfolk Southern.

Justice did not look at that kind of competition. It did not look at source competition, where we both serve, for example, a powerplant, although from different mines. There we are in direct competition just as we are in the Buffalo, Pittsburgh, St. Louis, and Chicago corridors that Justice did look at and in which their divestitures purport to take care of the competitive injury.

The Justice study indeed looks as if Justice were really acting as the antitrust counselor to the Department of Transportation, rather than in its normal role as prosecutor or its normal role when they appear in opposition to a merger before the ICC.

It is as if someone came to me and said: Mr. Wilson, how can I put these two companies together? And I say: Well, I cannot tell you that; you will never get it past the Department of Justice. He says: That is not what I asked you; what is the minimum I can do in order to make this merger palatable?

It looks as if that is the kind of advice that was rendered here, rather than Justice acting in its usual role as prosecutor. The whole process has left important unanswered questions about this merger. There are fundamental issues of national policy which have not been addressed—questions of antitrust policy, of the national transportation policy, of sound tax policy. I think all these issues have been ignored.

Now, I want to deal for just a few minutes with some of those questions. About a week ago, then Assistant Attorney General McGrath, testifying before the Judiciary Committee, said he was worried that we were going to due process this transaction to death. Well, if due process means asking the kinds of questions that we normally ask about a transaction of this type, and this one is going to create the largest transportation company in the Nation, then I am in favor of due process.

If it means asking why this particular transaction must be given various kinds of unprecedented legislative relief, then I am in favor of due process.

If it means asking why DOT thinks Conrail needs a security blanket in the face of the USRA conclusion that Conrail is viable for the long term, then I am in favor of due process.

If it means asking whether this transaction runs counter to our basic national policy of competition and to the national transportation policy, then I am in favor of due process.

I understand, Mr. Chairman, that you are particularly interested in the effect of a Conrail-NS merger on Midwestern railroads. In that region, as well as where we compete in the East, the elimination of competition is going to adversely affect shippers and railroads alike.

For example, let us take Nebraska wheat. Nebraska wheat can move either in its raw form as wheat or it can move as flour. We compete by moving it as wheat to Buffalo, where it is milled and then taken to end markets. NS and CSX on a joint route compete for that same move, only they carry it as milled flour.

That and many other instances of competition are going to go if Conrail goes. So we do have a lot of these unanswered questions on this record. But there is no need, I think, to consider the serious deviations from antitrust policy and from the national transportation policy and from tax policy which DOT and NS seem to believe that their transaction requires.

We at Conrail think there is a better way to return Conrail to the private sector. It is a way which is consistent, rather than in conflict, with the antitrust laws. It is consistent with the national transportation policy. It does not require us to deviate from sound tax policy.

We think that a public offering will preserve, rather than eliminate, competition. It is a better way to get a maximum return for the Government. It is a better way to preserve rail service and to preserve jobs.

I think it is safe to say that that alternative has not been fully explored to date. But in the process which has been conducted so far and which is proposed by DOT, it will not be. DOT has never been willing to part with its stock in a public offering, and where there is no willing seller it is difficult to find buyers to purchase the stock and assume the risk of a subsequent public offering.

But despite that difficulty, we are working on that alternative. We are making substantial progress because we, together with others, believe it is a better way to return Conrail to the private sector.

Thank you. May I request that my full statement be put into the record.

Senator **Pressler**. Without objection, it is so ordered.

[The statement follows:]

STATEMENT OF BRUCE B. WILSON, VICE PRESIDENT, LAW, CONSOLIDATED RAIL CORP.

Mr. Chairman, and Members of the Committeee, good afternoon. My name is Bruce B. Wilson. I am Vice President-Law of Conrail. Before coming to Conrail, I was an antitrust lawyer, and I served as Deputy Assistant Attorney General in the Antitrust Division from 1971 to 1976. I appear before this Committee today both as an antitrust professional and as Conrail's chief legal officer.

The sale of Conrail to the Norfolk Southern Corporation is one of the most important transactions in transportation history. It will create the largest transportation company in the country, and will have a profound impact on the Nation's most fundamental transporation and competition policies. It, therefore, requires full and careful scrutiny.

Moreover, the authorizing legislation prepared by the Department of Transportation raises profoundly troubling issues, including re-regulation of the rail industry, changes in ICC jurisdiction, immunity from antitrust scrutiny, and many other unprecedented provisions only tangentially related—if at all—to the sale of Conrail. Because of changes proposed in Conrail's Employee Stock Ownership Plan, the proposed legislation may also subject the United States to significant Tucker Act claims. In addition, the legislation is without precedent in guaranteeing tax benefits to NS.

Finally, the sale of Conrail to NS would require redrawing the Northeast/Midwest rail map—a process fraught with peril and one which has often failed in the past. This time the map-drawing efforts labor under a particular handicap—little or nothing is known about the DOT/NS' divesiture plan or about the ability of the divestiture carriers to provide long-term, competitive rail service. The prohibition against any future judicial or administrative review makes these matters all the more troubling.

These hearings are the Committee's first since the DOT legislation has been before it. I urge the Committee to refrain from acting on DOT's proposal until some of the aspects of the legislation not directly related to the sale of Conrail are fully explored and until the Department of Justice completes a review of the proposed divestitures. To act in the absence of such information will only further the perception of a transaction negotiated and approved without public input or scrutiny. This transaction deserves more.

The goal of returning Conrail to the private sector is one everyone shares. The question before this Committte—and one which this Committee is uniquely qualified to judge—is how to accomplish this goal in a way that enhances the national transportation policy. Since the United States Railway Association has just this week reaffirmed Conrail's long-term financial viability, the Congress can accord this transaction the scrutiny it deserves, knowing that Conrail, far from needing an immediate "security blanket," as the Department suggests, plays a vital and necessary role in the nation's transportation system—a role that must be preserved if the goals of the national transportation policy are to be met.

The Interstate Commerce Act spells out that policy very clearly. It is the product of many years of debate and many pieces of legislation, culminating in the Staggers Rail Act of 1980. It is the declared national policy to "ensure the development and continuation of a sound rail transportation system with effective competition among rail carriers," "minimize the need for Federal regulatory control" over the industry and "avoid undue concentration of market power." The proposed legislation to implement the sale of Conrail to the Norfolk Southern runs directly contrary to these policy goals enacted less than five years ago. The Department of Transportation's proposed sale carriers with it the return of federal regulation of rail pricing, eliminates competition, and greatly increases the concentration of market resources in an already heavily concentrated industry. It creates a mega-railroad that will possess 50 percent or more of the Northeast/Midwest rail market for chemicals, grain, automobiles, metals, scrap, and auto parts, and reduces overall competition in the Eastern half of the country from three major carriers to two and, in hundreds of specific instances, from two to one. It thus flies in the face of the Interstate Commerce Act's mandate to avoid undue market concentrations, and the fundamental Staggers Act premise that competition is the cornerstone of a deregulated industry.

These anticompetitive consequences will not be remedied by the DOT/NS "quick fix" divestiture proposal. Norfolk Southern and DOT propose to divest lines whose acquisition, rehabilitation, and maintenance will require tens of millions of dollars. The divested lines are to be acquired by Guilford Transportation Industries and the Pittsburgh and Lake Erie RR who, between them, lost $75 million over the last three years. Traffic density on the divested lines is low. In many cases, the lines carry less than one-twentieth of the traffic carried by competing lines retained by Conrail and NS. No estimates of the ability of Guilford and P&LE to attract new traffic have been provided; the fact is that the merged Conrail-NS will likely divert traffic from P&LE and Guilford.

Through divestiture, NS would be ridding itself of unprofitable, low density lines, saddling its smaller competitors with lines needing substantial rehabilitation and maintenance, and with few prospects for traffic. One could easily have imagined NS demanding that it be permitted to divest or abandon these lines as a condition of acquiring Conrail. Instead, NS is being permitted to merge the best of NS with the best of Conrail, ridding the system of its least desirable pieces.

As of last week, the proposed divestiture plan had not even been submitted to the Department of Justice for it to consider whether that plan meets its requirements for remedying at least some of the anticompetitive consequences of the proposed merger. Surely, Congress' consideration of the authorizing legislation ought, at a minimum, await the Justice Department's review, since the Department of Justice concluded that absent such divestitures the merger would violate the standards of the Clayton Act and the Interstate Commerce Act.

Nonetheless, DOT asks Congress to exempt the transaction from every municipal, state, and Federal law, including the antitrust laws, and to make it and its future implementation permanently immune from judicial review. DOT makes this request despite the fact that neither the ICC nor any independent administrative agency or court has scrutinized the transaction, and no opportunity has been accorded the public to assess and comment on its impact. The grant of immunity under these circumstances would be unprecedented. Moreover, if the planned divestitures satisfy the Justice Department's concerns, immunity should be unnecessary.

Finally, the transaction as outlined in the proposed legislation is extraordinary because it undermines the important pro-competitive regulatory reforms of the Staggers Rail Act of 1980 and the Interstate Commerce Act's insistence on the lessening of federal regulatory control over the rail system. It thus destroys the carefully crafted and delicately balanced compromise embodied in the Staggers Act, and it accomplishes this without public hearing.

A major goal of the Staggers Act reforms was the economic revitalization of the railroad industry. Congress found that railroad earnings were the lowest in the transportation industry and were insufficient to stop further deterioration of the rail system.[1] A primary cause of the railroads' financial problems, Congress found, was the joint rate system which, with the commercial closing doctrine by which it was enforced, effectively equalized every rate between the same points.[2]

That scheme was the antithesis of competition. Moreover, in order to maintain it, it was necessary for the railroads to agree on the rates to be applied. This required antitrust immunity. The elimination of equalized rates and collective ratemaking was at the heart of the pro-competitive reforms of the Staggers Act. Congress stated:

"[B]y allowing the forces of the marketplace to regulate railroad rates wherever possible the financial health of the railroad industry will be improved and will benefit all parts of the economy, include shippers, consumers, and rail employees." [3]

Nonetheless, the merged Conrail/NS entity would be required, under the DOT legislation, to "maintain or re-establish" certain joint rates and through routes, thus apparently resurrecting a bygone regulatory era.

Re-regulation may also result from the Justice Department requirement that the merged company provide access to other rail carriers (so that the latter may serve shippers located in markets they do not now reach) "on customary terms and conditions." Identifying and agreeing to charge a "customary" rate for competitive access, which will require antitrust immunity, raises important regulatory concerns. More fundamentally, competitive access, and the price to be paid for it, are subjects of debate at the ICC and in Congress itself.

Some of these new regulatory requirements would be enforced by the Special Court. Others are committed to an arbitration process. Still others are committed to the unreviewable discretion of the Secretary. Since the usual regulatory body—the ICC—already has jurisdiction over similar matters, the legislation will result in a quadruple-track regulatory scheme highly likely to yield inconsistent results and certain to cast the carefully crafted regulatory scheme into disarray. It will be very difficult to know what matters are to be enforced in which form, and to which matters antitrust immunity will attach. And it is beyond doubt that these provisions violate the national transportation policy goals of eliminating collective ratemaking and relying to the maximum extent possible on competition and demand to set rail rates.

Finally, because the proposed legislation gives permanent antitrust immunity to the merger *and* its implementation, many other anticompetitive abuses are possible. Can the merged Conrail/NS set anticompetitive switching rates because its actions are immunized as part of the implementation of the merger? Or set rates collectively with Guilford or P&LE because that conduct, too, would be immunized as part of the merger? The immunity is very broad; the "transaction" is very vague. The immunity may be argued to cover even the most remote consequences the new rail entity can relate to the merger. Every pro-competitive underpinning of the Staggers Act will thereby be undermined. More fundamentally, these regulatory changes are totally unrelated to Congress' mandate that Conrail be returned to the private sector and have no place in the sale legislation.

Divestiture and antitrust immunity are not the only areas in which you are being asked to sign a blank check. To be resolved after the legislation is enacted—without Congressional, administrative or judicial review—is what will be paid for the 15 percent minority interest held for Conrail's ESOP. Under the jurisdiction and indemnification provisions, we *do* know now that the United States has potential liability for any damage to the ESOP, just as it had ultimate liability in the Penn Central valuation cases.

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[1] H.R. Rep. No. 96-1430, 96th Cong. 2d Sess. 79 (1980).

[2] Id. at 111.

[3] Id. at 89.

Also to be resolved after the legislation is enacted is the final wording of the covenants in the final sale agreements. Congress will have no say over what it means to be headquartered in Philadelphia, or have shops in Altoona, or maintain economically justifiable service. The covenants will be administered by the Department of Transportation—again without Congressional, administrative, or judicial review. Aggrieved parties are not eligible to enforce these covenants. The Department alone, without review or procedures for independent input, will decide structural, financial and pricing issues.

By a series of "representations," which the legislation explicitly acknowledges may be false, and authorizations to sue, the proposed legislation would modify the Internal Revenue Code for the exclusive benefit of Norfolk Southern. Under the legislation, Treasury may treat Norfolk Southern just like any other corporation, but as Treasury collects the taxes, Transportation will hand the money back to Norfolk Southern.

One remaining peculiarity of the legislation is that it leaves in place the provisions for the breakup of Conrail. Why doesn't DOT request its repeal? Certainly, the Department would not suggest, should the Norfolk Southern transaction not be consummated, that the government would be left with no alternative but to dismember a profitable, vigorous Conrail? USRA said only last week that Conrail could expect substantial profits each year at least through 1988. We are also puzzled why Section 401(e), providing employee rights that are to be satisfied by the Norfolk Southern sale, is repealed immediately, rather than upon consummation of the sale.

The proposed sale violates other policies embodied in the Interstate Commerce Act, which makes it clear that a proposed rail merger is not in the public interest, unless full consideration is given to its impact on adequacy of transportation to the public; other rail carriers in the area; the total fixed charges that would result; employees; and competition among rail carriers.

No such consideration has been given to this proposal. It has been negotiated without any public scrutiny or input. Entities that rely upon competitive rail services have not been allowed the opportunity to analyze the transaction and voice their concerns. Rail competitors who have sought to explain the transaction's impact on them have been turned away. I urge this Committee to conduct the careful review that is required by the public interest.

If such review is not made before the transaction is approved, it will certainly not be made thereafter. The legislation proposed by DOT would have the merger "deemed approved by the [Interstate Commerce] Commission under Chapter 113 of Title 49, United States Code." Behind those innocuous words is Section 11341 of the Interstate Commerce Act that says: "A [rail] carrier * * * participating in [an] approved * * * transaction is exempt from antitrust laws and from *all other law*, including state and municipal law, as necessary. * * *" (Emphasis added.) Immunity of this sort is most unusual, and when granted has always been premised on completion of a thorough and searching proceeding by the ICC. No such proceeding is contemplated here; yet DOT and NS contend that antitrust immunity is vital. If the merger is in the public interest and is free from antitrust risk, why is this extraordinary relief required?

DOT's answer appears to be that immunity is required because the Justice Department found that the merger, absent supposedly curative divestitures, would have "a significant adverse effect on competition." This answer leads only to more questions. First, should the opposite conclusion be reached—that, given these risks, no antitrust immunity should be granted to the transaction? Second, since NS and DOT have agreed to divestitures that purportedly meet DOJ's concerns, why does immunity continue to be needed? The answer to these questions is that the likely adverse effects of the sale go well beyond those identified by Justice and grossly undermine the basic tenets of the national transportation policy that Congress labored so long to establish. I want to identify some of these effects for the record.

Because the Department of Justice's review of the transaction took a very narrow view of competition, it left an incomplete record with respect to the anticompetitive consequences of the proposed sale. There are three basic types of competition between Conrail and NS, only one of which was recognized by the Department of Justice. First, there is parallel line connection between origins and destinations served by both carriers. This type of competition was the subject of DOJ's publicly released analysis which concluded that the transaction has serious anticompetitive consequences, requiring divestiture of Conrail and NS assets to other carriers. Second, there is competition at origins or destinations served by the two carriers. Finally, there is what I call national market competition which arises when a shipper or receiver competes in a national market and requires the assistance of its local carrier to help it compete successfully in those markets. These last two forms of competition were not addressed in DOJ's publicly disclosed analysis, but they affect more traffic—half a billion dollars' worth in 1984—than does the first.

Parallel line competition between points now served by both carriers occurs in Illinois, Indiana, Maryland, Michigan, Missouri, New York, Ohio, Pennsylvania, and West Virginia. For example, Conrail and NS compete head-to-head for Chrysler's auto parts business. To win this business, Conrail operates a special train running between Chrysler plants in Michigan, stopping at each to pick up carloads of auto parts that are then moved to assembly plants in St. Louis. Conrail's special train completes the run in four to five days less time than the service provided by NS. Chrystler saves $1 million a year in reduced inventory costs alone, and the Conrail special train facilitates use of "just-in-time" manufacturing techniques. In February of this year, Chrysler recognized Conrail's innovative service with a special award. I question whether the incentive to offer this special service will still exist if Conrail is acquired by NS.

While DOJ studied head-to-head competition, it apparently ignored real movements of traffic, such as the one I have described, and it ignored offers by affected parties for data related to actual point-to-point movements. Justice looked, instead, at competition to or from named counties. Two months later, in its analysis of the proposed Southern Pacific/Santa Fe merger, the Justice Department acknowledged that rail traffic is appropriately studied in "origin-destination pairs," [4] since "it seems almost certain that different sizes of geographic areas are appropriate for different kinds of products." [5] However, even the effects on "county competition" were enough to lead Justice to conclude that, standing alone, the merger would violate every existing merger standard. It was in order to remedy these violations that the Department proposed the limited divestitures of certain Conrail and NS lines, which conflict with Congress' 1981 mandate that Conrail be sold intact, and are wholly inadequate as substitutes for the competition that will be lost. Even if the divestitures could do the job, they do not address the loss of origin and destination competition. This is a serious omission, and one not repeated in the Justice Department's SP/Santa Fe analysis which acknowledged that such competition "is very effective in constraining the prices charged by carriers * * *." [6]

For instance, Conrail and NS often compete for the first leg of a movement ultimately destined to a point served by only one or the other of them. Chrysler again provides a good example because it puts up about $40 million of outbound auto parts business for bid every year or two. NS could take the traffic from origin to destination by itself. Conrail competes only on the first leg and must interchange the traffic with NS to get it to destination. It ought to be easy for NS to win that competition. But Conrail won it by offering better rates and better service. Shippers and consumers benefit from this type of competition, but the Justice Department failed to consider it.

The Justice Department also failed to look at the reverse situation—when traffic originates at points served only by one carrier but is destined to points served by both. For example, a large Midwest power company purchases coal from producers located in different parts of the country and served by different railroads. Conrail offers an attractive rate for the low sulfur coal originating on its line in West Virginia to make it competitive with coal originated on the Chessie and the NS. Moreover, Conrail is building track into a new West Virginia mine so that it can make use of Conrail's rates and compete for the power company's business. Many people benefited from Conrail's actions: The coal mine in West Virginia, which would not have existed without Conrail's help; the utility, which pays less for its coal because it has companies competing for its business; and, of course, the consumers of electricity who pay less for it because Conrail and NS compete. The Justice Department didn't count this. Yet this competition, too, will disappear if Conrail does.

In addition, the Justice Department failed to address the lessening of competition for cross-country traffic, originating outside both Conrail's and NS' territory but terminating within. Competition between the two carriers to deliver this traffic is vigorous, and the resulting rate and service benefits to the customer are significant. The wheat and flour industries in Nebraska and South Dakota are among the beneficiaries of this competition.

Farmers in Nebraska ship wheat to bakeries in the East, and can be served by both Conrail and the NS. NS rates on flour compete with Conrail's rates on wheat, benefiting Nebraska farmers, wheat processors, such a Cargill and Conagra, eastern bakeries, and their customers. A Conrail/NS merger will eliminate this competition and its benefits.

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[4] ICC Finance Docket No. 30400; Verified Statement dated March 21, 1985 of Dr. Russell W. Pittman, of the Economic Policy Office of the Antitrust Division, at 43.

[5] Id at 12.

[6] Id at 9.

Similarly, Conrail and NS compete for wheat traffic from South Dakota to the East. South Dakota farmers ship their wheat to Minneapolis, where it is graded and stored. From Minneapolis it is shipped to Chicago, where both Conrail and NS can carry it to the East for processing into flour and truck delivery to bakeries. Conrail and NS compete directly for this traffic. Again, South Dakota farmers, wheat processors, bakeries in the East, and their customers benefit.

Failure to consider these forms of competition makes a mockery of the national transportation policy requirement of "a sound rail transportation system with effective competition among rail carriers" and of the Interstate Commerce Act requirement for scrutiny of a proposed merger's effect on "the adequacy of transportation to the public." (49 U.S.C. 11344(b)(1)(A)).

Justice also failed to address the national market competition I spoke of earlier. An example may help to explain what I mean. To help Bethlehem Steel compete in the national steel market, Conrail has reduced its rates on inter-mill traffic in each of the last three years. These rate reductions are offered becasue it is in Conrail's interest to keep Bethlehem Steel competitive with steel producers served by other carriers like NS. A combined NS/Conrail system would control so much of the rail market for steel that it may be able to raise prices with impunity.

Finally, the proposed sale will eliminate another, more intangible, competitive benefit. The Justice Department's merger guidelines stress that the Department is "more likely to challenge a merger" if "the firm to be acquired has been an unusually disruptive and competitive influence in the market." Conrail is exactly that sort of unique competitive resource and, since its inception, has worked hard to implement public policy in favor of competitive rate marketing. In 1980, Conrail led the fight for the Staggers Act and ever since has been aggressive in its efforts to enhance the competition the Act sought to bring to the rail industry. In 1981, Conrail withdrew from the rate bureaus in which rates had been set collectively for over one hundred years. To this day, it remains the only railroad to have done so. In 1981, Conrail began its challenge to the equalized joint rate system. Against the strenuous opposition of those who benefit from this anticompetitive scheme, Conrail has fought for the right to price its services independently and, therefore, competitively. Today, Conrail leads the industry in developing computer technology to facilitate such independent pricing. These actions enhance the pro-competitive goals of the transportation policy.

Moreover, these efforts benefit shippers directly. For example, in 1984, Conrail developed a program to blend low sulfur coal mined on lines it serves in West Virginia with high sulfur coal mined in Pennsylvania. This blending results in coal of a quality suitable for export. Conrail lowered the rates on the West Virginia coal so that it could bring it to Philadelphia, blend it with the Pennsylvania coal, and still be price competitive with export coal marketed by NS and Chessie. As a result, Conrail has created new markets for Pennsylvania and West Virginia coal. Because of these extra efforts, Conrail doesn't make as much money on this export coal traffic as NS makes on its export coal. But we helped our customers capture some of the export coal market. If Conrail and NS merge, the combined system would have little incentive to help Pennsylvania and West Virginia mines compete with NS' existing—more lucrative—export coal business.

In sum, the competition that exists today between Conrail and NS means billions of dollars to shippers and consumers. In addition, it means a lot to the industries involved in the examples I've cited. Conrail helped Chrysler in its remarkable recovery; it's helping Bethlehem Steel; and it is helping to create jobs for depressed coal industries in West Virginia and Pennsylvania. These are the real beneficiaries of the competition that would be lost in a Conrail/NS merger. Eliminating Conrail as a unique competitive resource would, thus, hardly enhance the fundamental national transportation policy goals of promoting competition.

These and other facts have not previously been put on the record. This transaction has been insulated from the public scrutiny usually afforded by the merger procedures of the ICC (and judicial review of the procedures), or by independent judicial review under the Sherman and Clayton Acts. Absent full public disclosure of the facts and circumstances that underlie the transaction, followed by an evidentiary proceeding at which all affected parties are permitted to explore its impact on the public interest, it should not be allowed to go forward. And surely, the error should not be compounded by immunizing the transaction from review in the future. While the legislation theoretically gives the Special Court jurisdiction over certain aspects of the transaction, a transaction specifically approved by Congress could hardly be overturned by that Court as failing to meet Congress' mandate. In fact, it would be virtually impossible to mount such a challenge, since the legislation fails to set forth standards for review, and gives no indication that the antitrust immunity permitting consummation of the merger would be withheld during the pendency of that review.

For these reasons, among others, I submit that neither the substance of the proposed Conrail/NS merger, nor the process by which it was negotiated, nor the prohibition on its future scrutiny serves the public interest. To the contrary, it violates every competition and antitrust principle and every tenet of the national transportation policy. The public, which contributed $7 billion to the restoration of viable, competitive rail service in the East, Conrail employees who worked to make it happen, and shippers who have only begun to reap the benefits of a stable, secure rail service, deserve better.

Senator PRESSLER. Indeed, the record will be left open for questions and additional comments.

Senator Ford requested that I ask both of you or all three of you to comment on the effect that this merger would have on CSX employees and labor agreements, especially as it relates to Kentucky, and he requests those for the record. So you do not have to do that here, but if you could submit those for the record and work with the staff on that, it would be much appreciated.

Let me ask—I too am getting a transportation problem here on time. But let me ask you both this question. You both heard the discussion about my concern about the impact of a merger on the Midwest. Could each of you give me your assessments on this issue, addressing specifically the areas of traffic diversions, divestiture and market destination control?

I know you have covered those to some extent, so you do not have to repeat yourself. But if you could expand just a bit.

Mr. WATTS. Shall I go first, Senator?

Senator PRESSLER. Yes.

Mr. WATTS. Yes, I have covered those in my prepared statement. But I would like to add that certainly we feel that there will be benefits accruing to the Western region and to the Midwest. Certainly we will have a strengthened East-West route via Kansas City on the combination of Norfolk Southern-Conrail. You will have a strengthened East-West route over Chicago, as Mr. Riley discussed in his earlier testimony.

Certainly we think that the ports of New York and Philadelphia will be strengthened from the Midwest and from the West by having accessible single line service from many additional points in the Midwest than those ports have today.

We think there are going to be new markets in the East opened to Western and Midwestern producers through improved transportation service. So that, while I have already discussed the diversion process and the impacts on the earlier diversion study by subsequent events, I do not think we should overlook that there are many positive impacts for the Midwest and for the West in an acquisition of Conrail by Norfolk Southern.

Mr. WILSON. Mr. Chairman, I am at somewhat of a disability on the diversion issue. That is because, while Mr. Riley has testified on diversions and he has had access to all the numbers, both Conrail and Norfolk Southern, and while Norfolk Southern has had access to the Conrail numbers, I have not had any access to the Norfolk Southern numbers.

All I have is my own numbers, and they do not tell me a whole lot about diversions. But as I listened to Mr. Watts say that he is going to strengthen the Kansas City gateway at one end and he is going to have access to all these new places in the East on the other, I wonder what is going to happen to those Midwestern railroads that operate between Kansas City and Chicago.

On the divestiture question, I think that that is really one of the important issues here, and it is an issue. When you just start to look at the numbers and what traffic is moving over the lines which are going to be divested and the strength of these carriers at least in recent years, one really has to wonder how anyone expects these divestitures to provide the kind of vigorous competition which now exists between the Norfolk Southern and Conrail.

The divested lines are going to require rehabilitation and maintenance expense for these companies in the area of tens of millions of dollars. P&LE has lost money for the last three years. Between them, these two carriers, Guilford and P&LE, have lost $75 million over the last 3 years.

In many cases, the divested lines presently carry less than one-twentieth of the traffic which the Norfolk Southern, if it merges with Conrail, is going to have on its mainlines. I do not think it is possible to measure the vigor of competition simply by looking at the lines that Mr. Riley had up here on the map before you.

In fact, if you look at the traffic on these lines, one could easily have imagined Norfolk Southern coming to the Department of Transportation and saying: Yes, we will acquire Conrail if you want us to, but we have got to have permission to abandon a few of these lines where we have low density traffic. And if you look at the lines that they are going to divest, those are precisely the same lines. They are the ones with low-density traffic on them.

So I do not see how the divestitures are going to be successful, and I query how this Congress is expected to vote on a bill which contemplates divestitures yet to be ruled upon by the Department of Justice when you have never seen them. What the executive branch—both the Departments of Transportation and Justice—are really saying is, please trust me.

Senator PRESSLER. I think that is a good point, and that is why I asked that we see the density on this beautiful map that we saw with all of the lines. And I think that is a very good point.

Mr. WILSON. If it is a typical density map, Mr. Chairman, you may have trouble seeing these lines.

Senator PRESSLER. Could you comment on my concern about the ripple effect of a Norfolk Southern-Conrail merger on branchlines in States like South Dakota? Specifically, assuming traffic is diverted from a Midwestern carrier's mainline, Chicago & North Western for instance, could it affect the branchlines in my State?

Mr. WATTS. Senator, again if I may start on that. The ripple effect in North Dakota I cannot find. I do not see how that would occur. But let us start with the premise, which is that the Chicago & North Western will not have the opportunity to handle traffic between Fremont and Chicago, the two specific points that Mr. Conlon referenced with respect to their bridging of traffic between the UP in the West and Conrail in the East.

Norfolk Southern, as Mr. Conlon said, has had discussions with the Chicago & North Western. They requested that Norfolk Southern make a commitment to maintain that route and to keep it open, and further, that Norfolk Southern agree to continue a current run-through service that the Chicago & North Western has between Conrail and the Union Pacific.

We have agreed to that request and have so informed the Chicago & North Western. I would be happy to supply a copy of our letter to you for the record with respect to that commitment if you care to have it.

Mr. WILSON. Again, Mr. Chairman, this goes to the question of who is right in the dispute of what is going to be diverted, because if there are diversions, as Mr. Conlon indicated there will be, that is going to take revenues away from the North Western.

And I think Mr. Watts will agree with me that it is an elemental principal of railroading—one that I think we may both have learned from the same gentleman—that you have to run a railroad so that your revenues exceed your costs. And if your revenues go down you have to take costs out of the system someplace.

Senator PRESSLER. Why could we not go ahead with the Heinz-Specter public offering proposal, and if it does not work in 3 months or 6 months or however long it takes then go ahead with the merger?

Mr. WATTS. Would you like to go first this time?

Mr. WILSON. Sure, I will go first.

I think that concept, Mr. Chairman, is a feasible concept. I certainly agree that if a public offering cannot be put together, then there must be another alternative. Whether at that point, after a full examination, the benefits of the Norfolk Southern transaction outweigh the injuries to these other policies which I discussed in my opening statement, that is the time to do that.

So I think that to go forward on that basis is certainly a feasible alternative at this time, and it avoids a current examination of these very important questions about antitrust and tax policy and the national transportation policy.

Mr. WATTS. Senator, I do not agree that it is feasible. Norfolk Southern has followed a prescribed procedure and has made a bid for Conrail. Our chairman has addressed that specific issue, Mr. Bob Claytor, before this committee.

FRA Administrator Riley just a few minutes ago addressed that issue to this committee, and I subscribe to Mr. Riley's views with respect to it. And let me add one further thing that he did not mention, and that is the impact on the employees of Conrail. Mr. Wilson is an employee of Conrail and we could ask him, perhaps. But it seems to me that in all that has gone on—and this has not been a hurry-up short process, but one which has been going on now since 1981—there is a great deal of uncertainty and a great deal of human concern about what is going to happen.

And the longer this is prolonged and protracted, the greater is that uncertainty and concern, and it will continue. And it not only will continue there, but it will continue on CSX with the grossly exaggerated and unfounded kinds of statements that are being bandied about, with 10,000 people going to lose their jobs on CSX and those kinds of numbers, which are completely unsubstantiated.

Mr. WILSON. Mr. Chairman, if I had to give Mr. Watts a sense of the employees at Conrail—at least the ones I have talked to—they certainly would prefer the current uncertainty to the acquisition by Norfolk Southern.

Mr. WATTS. Senator, since that was a rebuttal question, perhaps I could ask one more of Mr. Wilson, whether or not he has taken some poll or just what is the scientific basis for the statement he has just made?

Mr. WILSON. I put the basis for my statement in my statement, Mr. Watts. I said "at least the ones I have talked to."

Mr. WATTS. Could I ask how many he has talked to?

Mr. WILSON. I have lost count.

Mr. WATTS. Thank you.

Senator PRESSLER. Now let me ask this. What kind of shape are the lines in that are to be divested?

Mr. WATTS. Yes, sir, I can address that, Senator. Mr. Riley addressed it basically, but let me take it in four segments.

First, the line from Buffalo to Cleveland. It is the line of Norfolk Southern, which Norfolk Southern operates today. It is a high speed line. It has centralized traffic control on it. Rail weights are 132 pound welded rail. It is a very good piece of railroad.

A second line, the Crestline or Conrail line to Chicago, the line over which a passenger train operates today, a high speed rail line in very good condition.

Third, a segment of tracks, a combination of tracks that the Pittsburgh & Lake Erie would acquire to give them access to the markets in Mingo Junction, Steubenville, Canton, and Massillon, as required by the Department of Justice, and flow that traffic to Cleveland and to Toledo. The lines that they would be acquiring, the so-called Wheeling & Lake Erie lines, are in good shape today. They are operated by Norfolk Southern today. That is our only access lines in that territory.

The fourth line segment, which completes the picture, is the line segment from Delphois, which is an intersection of the line east-west, the Conrail line that they would acquire, that Guilford would acquire, into St. Louis. By and large, that line is in good condition. There are segments of it today which have light traffic on it and those are the lines that Mr. Riley referenced in his response which would need timbering and surfacing.

Mr. WILSON. Our estimate, Senator, is that it is going to require about $168 million to put these lines into shape to provide competitive service. That includes not only rehabilitation of the track, but some construction that is going to be required.

I agree that the Buffalo-Cleveland line is a fairly good line. Our Fort Wayne line is a high speed line, but it is not a line that has continuous welded rail on it, as our other route to Chicago does. Mr. Watts would have to testify as to the line to St. Louis.

I do know that there is at present no connection, for example, between the line running through Delphos to Crestline and the line from Crestline to Cleveland, and one is going to have to be constructed. That is not going to be easy since there is a highway bridge that sits right there. I would imagine some sort of rail yard is going to have to be constructed at Delphos because that is where Guilford would split its St. Louis and Chicago traffic.

In short, we suffer from the lack of having an operating plan with respect to the divestitures or really knowing much about them at all, because there is nothing of record with respect to the divestitures or how Guilford is going to operate them these lines. That goes back to the diversion problem. We do not have an operating plan as to how Norfolk Southern is going to operate the merged railroad.

If we were in a normal proceeding, we would have all of these things. As a matter of fact, we do not even have pro forma financial statements at this point.

Senator **Pressler**. I might ask you both to comment on Arlen Specter's resolution for the record, and I will provide you with a copy of that. It is a separate thing that you may not have seen yet.

Also, my final question here today is to ask the representative of Norfolk Southern, tell us how you went about selecting the tracks and the acquirer for the divestiture?

Obviously, I assume you did so within the Department of Justice guidelines. But from a practical and logistical perspective, how did you go about it? How did you solicit bids? Who did you contact? Who contacted you?

Mr. **Watts**. Certainly, sir. First, we start with what the Department of Justice required Norfolk Southern to do to obtain their approval for an acquisition of Conrail, and that was to provide an additional carrier in certain markets, certain locations currently served by Norfolk Southern and Conrail, and to provide access in the East at Buffalo and Pittsburgh and in the West at Chicago and St. Louis for that carrier to connecting carriers at those four gateways.

The Department of Justice did not prescribe specific lines, nor did they prescribe specific acquirers. Norfolk Southern immediately began to receive inquiries from a variety of interested parties, both railroads, the regional railroads in the area and other interested parties, including some nonrailroads.

We sat down with each of those interested parties and discussed the Department of Justice requirements and ways that those requirements could be addressed. We certainly went into those negotiations with an idea of lines that could be divested to meet the Department of Justice requirements.

During the process of the negotiations and following careful inspection of all of the properties that were available, we arrived at a bilateral, if you will, determination of the lines that would be divested, meaning, quite candidly, that the Guilford system and subsequently that the Pittsburgh & Lake Erie had demands for lines, in some cases different lines than the lines that we had initially included, and we acceded to those requests.

And they also had requests for additional lines that were outside the Department of Justice requirement for operating reasons of their own, and many of those are in the divestiture agreement that is currently the agreement in principle that we have with both Guilford and the P&LE.

That is the process we have gone through. We are currently—and this is a complex matter for the acquiring carriers, complex on several levels. One, they must determine how they will operate the properties postacquisition. And they know, as we know, that once we have arrived at a final contract, that that contract will have to be reviewed by the Department of Justice and judged by the criteria that the Department of Justice has made very well known as to how they will judge the acquisitions and the divestiture.

Senator **Pressler**. Good.

I want to thank our witnesses very much for this hearing, and I will declare this hearing closed.

[Whereupon, at 4:17 p.m., the committee was adjourned, to reconvene upon the call of the Chair.]

ADDITIONAL ARTICLES, LETTERS AND STATEMENTS

STATEMENT OF THE AMERICAN FROZEN FOOD INSTITUTE

The American Frozen Food Institute (AFFI) commends the Senate Commerce, Science and Transportation Committee for conducting hearings on the Department of Transportation's recommendation on the sale of the Consolidated Rail Corporation (Conrail) to the Norfolk Southern Corporation.

AFFI is the national trade association representing frozen food processors and manufacturers. Our present packer membership accounts for approximately 80 percent of the total United States production of frozen food valued at approximately $26 billion annually. Our members are located throughout the United States and are engaged in the manufacturing, selling, transportation and distribution of frozen food to customers in all of the states and to many nations abroad.

AFFI supports the public offering disposition of the stock holding of the federal government in Conrail as proposed by Conrail's management on October 24, 1984, at a public hearing held in Harrisburg, Pennsylvania.

AFFI members are substantial users of rail transportation. Rail transportation services provided by the nation's railroads are an essential component of the total system for distributing frozen foods to their ultimate consumers.

Due to the important role that railroads play in the distribution of frozen foods, AFFI and its members have a substantial interest in the disposition by the federal government of its interest in Conrail. Conrail provides an important competitive transportation alternative in the Northeastern states.

This important role has been heightened by the recent action of the Interstate Commerce Commission in exempting from regulation the rail transportation of frozen foods. Shippers and receivers of frozen food by rail must rely heavily on the availability of competitive alternatives to prevent abuse of market power by rail carriers in providing rates and services for frozen food transportation.

The present management of Conrail has made that carrier a viable component of the overall national transportation system. As such, it is an important part of the total national distribution system for frozen foods. That viability has been created by the present management team which has been operating Conrail for the last few years.

Under the Northeast Rail Service Act of 1981, 45 U.S.C. §§ 761-763, the Secretary of Transportation is to submit to Congress a plan for the sale "in block or by public offering" of the interest of the federal government in the common stock of Conrail. Such a plan is required to insure continued rail service, to promote competitive bidding for the common stock and to maximize the return of the United States on its investment.

AFFI urges you to adopt the public offering plan proposed by Conrail management. Conrail management has achieved a high level of management efficiencies and innovations which are reflected in the strong financial performance of the railroad. In addition, the employees of Conrail have reached major agreements with Conrail management which have involved a significant contribution on the part of the employees to the railroad's success.

Finally, as the Northeast Rail Services Act indicates, the sale of Conrail should maximize the return of the United States on its investment. The several billion dollars invested by the states through their efforts, must be recognized, as well, in any proposed sale.

AFFI believes that the proposed public offering of Conrail's common stock offers the greatest likelihood of preserving and expanding the achievements already made by Conrail management. At the same time, a public offering would provide the best means of efficiently and profitability returning Conrail to the private sector.

AFFI respectfully urges you to consider these factors in arriving at your decision on how to dispose of the United States' interest in Conrail.

We stand ready to answer any questions or address any comments you may have on this issue.

Thank you for this opportunity to express our views.

THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE,
Washington, DC, March 15, 1985.

Hon. JOHN C. DANFORTH,
Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate, Dirksen Office Building, Washington, DC.

DEAR CHAIRMAN DANFORTH: This will supplement my February 26 letter transmitting comments for your committee's hearing record on Conrail's transfer to the Norfolk Southern.

There are two League committees, the Railroad Transportation Committee and the Legislative Committee, currently reviewing the Memorandum of Intent, divestiture provisions outlined by the Justice Department and various other options for return of Conrail to the private sector. The results of this analysis will be communicated to you and other members of the Committe when finalized.

In the meantime, there are several concerns which have surfaced since the League's testimony was submitted that we would like to call to the committee's attention as it considers legislation on this matter. They are:

1. Shipper concerns that the covenants or proposed divestiture of rail track or carrier lines are not adequate to promote meaningful rail to rail competition.
2. The proposed divestitures should permit competitive industry access by more than one railroad if more than one railroad is permitted to serve an industrial city. The divestiture program provides no mechanism to assure access to all industries located at those points.
3. The Memorandum of Intent provides a framework for continued competitive alternatives for east-west traffic, but is lacking in assuring competitive alternatives on north-south traffic.
4. Insufficient or the absence of information on financial alternatives to the direct sale to Norfolk Southern, including a public stock offering.
5. The expedited timetable by Congress for disposition of the Conrail matter unduly limits the opportunity for those directly affected to provide meaningful input on the DOT or alternative proposals.

On March 6, the League assembled almost 30 key shippers representing a broad range of commodity interests for a meeting with the Federal Railroad Administrator to discuss competititve access considerations and other issues. One important element of information that shippers are not receiving relates to the lines proposed to be sold by Conrail or Norfolk Southern to other railroads. Although systems maps are not available from the Federal Railroad Administration or the Department of Transportation, we were informed that the proposed transfer of lines to Guilford would involve the old Nickel plate main line and that the P&LE would acquire trackage rights and other options involving the old Pittsburgh and West Virginia line. Additionally, we learned that Guilford would purchase the 188 miles of NS line between Buffalo, New York and Cleveland, Ohio. It would also receive trackage rights to operate over certain Conrail lines and would purchase Conrail lines betwen certain Ohio points and Chicago, Illinois. The complete details, as we were able to develop them, were furnished to all League members on March 8 (see copy of NITL Notice enclosed).

A number of League members have expressed concern that the lines to be transferred or sold to Guilford or other acquiring railroads are not sufficient for the acquiring carrier to be competitive with the Norfolk Southern. Before any sale of existing NS or Conrail lines is finalized, the League believes that additional information is needed with regard to the condition of the track and roadbed at issue, and whether or not the acquiring railroad will be truly competitive with Norfolk Southern. Additionally, there are concerns that the acquiring carriers will not have sufficient motive power or equipment to meet the requirements of their shippers on their lines.

The Secretary of Transportation has indicated that the divestitures will strengthen competition in the Conrail service region. Where there were three competitive railroads before the sale, there will be three afterwards. Where there were two, there will still be two. This is not necessarily providing competitive service at those city points. Access to terminals or cities does not mean access to all industries located at those cities. A covenant should be provided in the sale agreement or a provision included in the legislation which would permit reciprocal switching for all industries at charges that are just and reasonable.

In other words, where more than one railroad serves the switching district, all railroads within that switching district should have access to shippers through reciprocal switching. Although DOT's proposal would preserve what we have now, there may be situations where existing carriers (whether Conrail, Norfolk Southern or others) have closed competitive access to industries exclusively served by them.

Several League members have expressed concern that the transfer of Conrail to the Norfolk Southern and the effort by DOT to provide competitive alternatives for shippers lacks north-south traffic considerations, while addressing east-west traffic concerns. This concern should be further explored before legislation is finalized.

At the March 6th meeting with Federal Railroad Administrator John Riley, shippers in attendance were provided additional information on the economics of the sale of Conrail to the Norfolk Southern and why DOT considered it a better alternative vis-a-vis a public stock offering. This additional financial insight is important and should be shared with all. Only when the public is fully aware of the various pitfalls involved with other than the Norfolk Southern transaction, will they be in a position to fully understand all ramifications.

With respect to the latter point, I would like to convey the growing apprehension being expressed to me by League members about the expedited handling of the Conrail sale which could foreclose the opportunity for those directly affected to provide meaningful input in this process.

Conrail has been a ward of the federal government for over nine years. The procedures for returning Conrail to the private sector have been thoroughly debated and discussed. For over a year now, DOT has been soliciting bids for the sale of Conrail; analyzing those bids and submitting its recommendation to Congress for disposition. We maintain that shippers have not had sufficient opportunity to analyze all the options available since the Secretary of Transportation announced the decision to sell Conrail to the Norfolk Southern. Lack of meaningful information on rail lines to be sold, financial matters, and other issues precludes timely and constructive evaluation of the issues and input to your Committee. The rush to judgment on this matter is unnecessary. A full analysis and review of the sale process by appropriate Congressional committees should be made. Legislation should not be progressed until shipper concerns are met.

In summary, the League believes that, at a minimum, your Committee should include in the legislation or as a condition to any sale of Conrail a provision that where more than one railroad serves a switching district, all railroads within that switching district should have access to serve those shippers and industries located on the lines of competing railroads through reciprocal switching at just and reasonable charges. This condition will go a long way toward promoting competition and assuring shippers access to competing railroads where that access is not available presently.

Your favorable consideration of our concerns will be greatly appreciated.

Sincerely,

James E. Bartley,
Executive Vice President.

Statement of the National Industrial Transportation League

Chairman Danforth, Members of Committee: My name is Joseph S. Dewey. I was elected to the vice presidency of the National Industrial Transportation League at the November 1984 annual membership meeting. In addition, I currently am director of transportation for Kerr-McGee Corporation Oklahoma City, and have been affiliated with Kerr-McGee for approximately 20 years. I have almost 30 year's experience as a corporate transportation professional. Accompanying me today is John F. Donelan, League's General Counsel.

The League is a voluntary organization of shippers, shippers' associations, boards of trade, chambers of commerce, and other entities concerned with transportation services of all modes. It is the only nationwide organization representing shippers of all sizes and commodities using all modes of transportation to move their goods in interstate and international commerce. Its members, directly or indirectly, are responsible for the routing of about 80 percent of the nation's commercial freight.

The League is pleased to be part of the historic process which begins this morning—Conrail's return to the private sector. When the Northeast Rail Service Improvement Act set this national goal three year ago, it was shrouded in uncertainty. Would anyone be willing to buy the railroad as an entity? Would it have to be sold piecemeal? Would the reforms contained in NERSA and the proposed changes in Conrail management be sufficient to halt the railroad's steady drain on the federal treasury?

We are happy to note that the spirit of cooperation embodied in NERSA has made this goal a reality. The cooperative efforts of the federal government, the state and local governments, as well as Conrail's consumers, the shipping community, have given this key economic region a viable rail network that serves the nation's commercial needs. Of course, a large part of the credit for this success story belongs to

Conrail's managment and its labor force. Without their tireless dedication and sacifices the dramatic improvement in Conrail's profitability and productivity might not have been possible.

In preparing for the transfer, the League has lent its full support to the Department of Transportation's efforts in selecting a purchaser for Conrail. Throughout 1984, the League sponsored a series of educational forums to familiarize the shipping community with the various purchase proposals. This effort culminated in a day-long workshop in which shippers explored the proposals of the key bidders as well as the goals and objectives of the Washington decisionmakers in the transfer process.

Based on the knowledge gained from this educational endeavor and the efforts of our Railroad Transportation Committee, the League last July informed the DOT about the three criteria essential to the railroad's successful return to the private sector. We firmly believe that unless these general criteria are the foundation of any transfer mechanism, Conrail's return to the private sector will not be permanent.

These criteria are: First, the transfer should be structured to minimize and, if possible, avoid any significant service disruptions to the region. Shipper support of the government's intervention into the bankruptcies of the 1970s was predicated upon the need to preserve essential rail service to the northeast and midwest. To ignore this issue would make a travesty of the government's almost $6 billion investment in Conrail, and cause untold economic hardship to the region through lost or diminished business opportunities. It would seriously exacerbate the precarious financial health of the nation's basic manufacturing industries.

Second, the transfer should maximize rail-to-rail competition so that transportation services in the region are improved by the efficiencies inherent in a marketplace environment. The need to foster effective competition throughout the railroad industry has been a topic of shipper concern for several years.

Third, the transfer should minimize, to the greatest extent feasible, the likelihood that Conrail will ever again need the federal government's financial support. We believe that any transfer should be financially sound. It also should minimize the opportunity for investor net return until after the railroad's operational and maintenance needs are met.

Since submitting these comments, the League has been carefully monitoring the events which are shaping the prospects for Conrail's future. As we are all well aware, there now appears to be several options for effectuating Conrail's return to the private sector. They include: (1) adopt DOT's recommendation to sell the railroad to the Norfolk Southern; (2) accept any of the other offers that have been made for the railroad; or, (3) pursue a public sale of the railroad's stock as recommended by Conrail management and certain concerned members of Congress.

The League's Railroad Transportation Committee and our Legislative Committee each are studying these options to determine their various impacts on the shipping community. We would note that each of these options have different ramifications for our individual members because of their unique transportation needs. Our goal in this analysis effort is to determine the benefits and problems these three transfer scenarios would generally create.

We hope to have this analysis completed within the next several weeks, and to be able to convey the results to you and your staff as promptly as possible. We think that our efforts to identify the general marketplace effects of these options will assist the Congress in making the tough policy decisions which lie ahead. We also look forward to assisting Congress in its efforts to communicate with the shipping community on this vital transportation issue.

Effective competition has been a topic of shipper concern for several years. At a recent Annual Meeting, our members overwhelmingly voted to adopt the following policy on railroad mergers: "The League supports the attachment of reasonable conditions to ICC approval of railroad merger applications that would retain and/or enhance competition through: (1) required reciprocal switching; (2) grants of trackage rights; and (3) required maintenance of, or opening of, economically viable gateways."

Since the transfer of Conrail will not come before the Interstate Commerce Commission, we would hope that in your role as the final arbiters of Conrail's return to the private sector you will give serious consideration to this issue in your policy deliberations.

The League is pleased to note that the Justice Department echoes the concerns expressed by many League members about the role effective competition plays in assuring our mutual goal on an efficient national rail system. In its letter report to the DOT on the antitrust ramifications of Conrail's transfer, DOJ effectively outlines the necessity of maintaining intramodal competition for this industry. We hope that you will carefully consider this report, and strive to foster this type of competitive environment for the Conrail region.

In addition to this issue, the League believes that any transfer mechanism must balance not only the public interest, but also the economic factors affecting business and industry and the states and communities in which they are located, as well as the future of our national rail network and its labor employees.

We thank you for this opportunity to present the views of the shipping community, and look forward to working with you and your staff to realize our mutual goal of a privately owned, financially sound Conrail. We will make the results of our current analysis effort available to you as promptly as possible.

I would now be glad to answer any questions you may have.

STATEMENT OF GEORGE L. BERG, JR., ASSISTANT DIRECTOR, NATIONAL AFFAIRS DIVISION, AMERICAN FARM BUREAU FEDERATION

The American Farm Bureau Federation is the nation's largest general farm organization with a membership exceeding three million member families in 48 States and Puerto Rico. I appreciate the opportunity to appear before the Senate Commerce, Science and Transportation Committee to outline Farm Bureau's position endorsing the sale of Conrail to the Norfolk Southern Corporation.

At the annual meeting of the American Farm Bureau Federation earlier this year, our voting delegates recommended that Conrail be returned to the private sector. Based upon the Department of Transportation's study of the competitive bids and the recommendation that the federal government sell its share of Consolidated Rail Corporation to Norfolk Southern, we believe the proposals should be promptly and favorably approved by the Congress.

Norfolk Southern's purpose in buying Conrail is to gain access to northeast and east-west markets. Shippers of both Norfolk Southern and Conrail can look forward to expanded markets, more single-line rates and fewer cancellations of joint rates and routes. Norfolk Southern has had an excellent record of moving farm products, especially grain, from the Midwest to the Southeastern United States. If this merger is approved, Norfolk Southern will be in a position to provide more direct routes, faster shipments and better use of equipment. We believe the merger will create new opportunities that will be helpful to agriculture and increase the efficiency and competitiveness of rail service in the Northeast and Midwest.

Farm Bureau believes there would be a number of advantages offered to shippers by Norfolk Southern. The railroad has a sound transportation background making Conrail financially sound and assuring shippers of continued rail service. The acquisition would represent a market extension for Conrail and Norfolk Southern. It would provide a high degree of operating efficiencies and permit more competitive rates and services to be offered rail shippers and receivers. The merger would also result in two balanced and competitive rail systems east of the Mississippi River.

Not only does the sale of Conrail to Norfolk Southern assure competition between two financially strong railroad systems in the East, but it also gives shippers the opportunity to enjoy greater competition from smaller railroads. In its effort to become less dependent upon federal subsidy, Conrail closed numerous gateways by cancelling joint rates on a massive scale. The effect of some joint rate cancellation has been to preclude some carriers from serving markets in the Northeast and Midwest. Before the Staggers Rail Act of 1980, joint rates provided shippers equal rates and the only competitive benefit was service. After the Staggers Act, joint rates provided both service and price competition through the use of "allowance contracts, i.e. a shipper could get a volume discount from some carriers thereby lowering the cost of a joint rate by using a specific route.

Norfolk Southern, as part of its original offer to buy Conrail, agreed to re-establish certain joint rates so that smaller carriers could re-enter the Northeast market on a competitive basis. Standing alone, Conrail is not in a financially secure enough position to tolerate such competition. However, if permitted to merge, Norfolk Southern will be financially secure and the combined system can recapture traffic that has left the rail system because of Conrail's present need to surcharge interchanged traffic.

Mr. Chairman, the federal government should not be in the business of running railroads. Now that Conrail is financially healthy and attractive to a number of bidders, it should be returned to the private sector. The Secretary of Transportation, with the advice and assistance of all interested parties, has recommended Norfolk Southern on the basis that it would leave Conrail in the strongest financial position after the sale, best preserve service to Conrail shippers, and give the taxpayers the best rate of return possible. Norfolk Southern's bid was reviewed and approved by the Treasury Department for tax implications and the Justice Department for competitive aspects. If we wish to get the federal government out of the railroad business, we believe the logical approach would be to sell Conrail to the Norfolk Southern Corporation.

In our opinion, Norfolk Southern's selection by the Department of Transportation as the successful bidder for the Conrail system offers a sensible, financially sound solution to the government's desire to return Conrail to the private sector. Norfolk Southern's long-term commitment to railroad service, its experience in managing a consolidated interterritorial rail system, and its substantial financial resources make it the best choice to purchase Conrail's extensive rail system.

ILLINOIS CENTRAL GULF,
Chicago, IL, April 3, 1985.

Hon. JOHN C. DANFORTH,
Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: I would like to commend you and the Committee for holding this extra day of hearings on the Conrail sale to receive testimony on the impact of the proposed transaction on the Midwest region. I regret that I cannot attend the hearing due to previous and longstanding commitments. However, I wish to take this opportunity to state further for the Committee's consideration the position of the Illinois Central Gulf Railroad (ICG).

The ICG is the seventh largest railroad in the United States in terms of revenues. As of December 31, 1984, ICG operated 6,506 miles of railroad in mid-America, extending generally from the Great Lakes on the north to the Gulf ports of New Orleans, Louisiana and Mobile, Alabama on the south, ICG serves the states of Illinois, Indiana, Iowa, Missouri, Nebraska, Kentucky, Tennessee, Mississippi, Louisiana and Alabama.

In the statement we submitted to this Committee on February 28, 1985, we expressed the position that a free-standing, separately operated Conrail would ensure the minimum degree of competitive rail service essential in the Northeast and Midwest regions. To this end, we believe that sale of Conrail to a non-railroad, either directly or through a public offering, is the best plan.

Clearly, the adverse effects of a combination of Conrail and the Norfolk Southern Corporation are not limited to the Northeast. Indeed, it can be argued that the most pernicious effects, even from the standpoint of competition, are outside of the Northeast. Norfolk Southern blankets the Southeast, extending to Mobile, New Orleans, and Memphis. In the Midwest, Norfolk Southern will extend Conrail's territory west to Des Moines, Omaha, and Kansas City. This proposed combination will create the nation's largest railroad and cause anticompetitive impacts throughout the Midwest and South.

The impacts on the ICG were delineated in our statement of February 28, 1985. We expect a minimum annual revenue diversion of $28 million to $51 million. Other midwestern railroads will doubtless suffer significant revenue diversion as well. Such revenue losses are bound to have a dramatic, near term effect on employment levels, service to manufacturers and distributors, and communities in the Midwest.

The Department of Justice analysis of the competitive impacts of the transaction is seriously flawed. First, it addresses only communities in the Northeast and does not consider the adverse impacts on connecting midwestern railroads and the communities they serve. Moreover, there is substantial doubt that an expanded Guilford system, as provided for in the Department of Justice's divestiture plan, will have the financial strength to be a viable competitor to the new Conrail/Norfolk Southern system. However, even if Guilford can survive, it will be totally ineffective as a means of assuring competitive access for midwestern carriers to Northeast markets. The vast majority of carloads destined for the Northeast will still terminate at stations served exclusively by Conrail, and Conrail will have the power, even if it joins in a through route with Guilford, to make that route noncompetitive through pricing actions.

The Government has played an extraordinary role in creating and financing Conrail. Including the $2.8 billion paid to the owners of the original bankrupt lines, the Government has invested over $7 billion in Conrail. The Government should assume the responsibility, commensurate with its extraordinary role in creating and financing Conrail, to return Conrail to the private sector in a manner which treats adversely affected carriers as fairly as possible.

If the sale of Conrail to the Norfolk Southern Corporation goes forward, terms and conditions should be required by Congress to preserve competition and ameliorate the adverse impacts upon the shipping community and connecting regional railroads. The Memorandum of Intent between the Department of Transportation and the Norfolk Southern Corporation states that Norfolk Southern will "* * * maintain or re-establish with the small eastern rail carriers of less than $300 million annual operating revenues reasonably direct and cost-competitive routes of major importance." This provision is not sufficiently definitive and fails to include any connecting railroads outside the Northeast.

Conditions should be adopted that require Conrail/Norfolk Southern to maintain competitive joint rates and through routes upon request of a medium size railroad connecting with Conrail, including establishing new competitive joint rates and routes. Such a condition would assure that existing interchanges with Conrail/Norfolk Southern remain open, and that connecting railroads and their shippers will be able to participate in rates and routes which will permit continued access on a competitive basis to northeastern markets.

Again, I want to thank you and the Committee for the opportunity to present these views. I will be pleased to provide you with additional information if necessary.

Sincerely,

HARRY BRUCE,
Chairman and Chief Executive Officer.

STATEMENT OF HARRY J. BRUCE, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, ILLINOIS CENTRAL GULF RAILROAD CO.

My name is Harry J. Bruce. I am Chairman and Chief Executive Officer of the Illinois Central Gulf Railroad Company (ICG). My business address is 233 North Michigan Avenue, Chicago, Illinois 60601.

The ICG is the seventh largest railroad in the United States in terms of revenues. As of December 31, 1984, ICG operated 6,506 miles of railroad in mid-America, extending generally from the Great Lakes on the north to the Gulf ports of New Orleans, Louisiana and Mobile, Alabama on the south. ICG serves the states of Illinois, Indiana, Iowa, Missouri, Nebraska, Kentucky, Tennessee, Mississippi, Louisiana and Alabama. We are major transporters of grain, grain mill products, chemicals, paper and forest products, coal, and trailer and container traffic. The Company employs approximately 10,000 persons.

Just 12 years ago, ICG operated 9,691 route-miles, but has since eliminated 3,185 miles, primarily through abandonment. During this period, ICG's annual carloads have declined 38 percent, from approximately 2.0 million in 1972 to 1.25 million in 1984.

While the reasons for this decline are complex, the increased concentration of the railroad industry into fewer and larger rail systems (with their ability to divert traffic from smaller, Class I railroads, such as the ICG) has undoubtedly been the most significant factor.

ICG connects with and interchanges traffic with Conrail or Norfolk Southern at numerous locations. In the states of Illinois, Indiana, Missouri and Kentucky, ICG and Conrail serve 15 common points, while ICG and Norfolk Southern serve 30 common points in the Midwest and Southeast.

A COMPANY IN TRANSITION

ICG is a railroad in transition. The cumulative effects of mega-mergers in the industry and the 1982–83 economic recession have put enormous pressure on the Company's ability to provide rail transportation service at a profit. In 1982, ICG's revenue decreased $138 million from 1981 to a level of $905 million. On that basis, ICG posted a pre-tax loss from continuing operations of $20 million in 1982, as opposed to pre-tax income of $74 million in 1981. In 1983, revenues declined still further to $881 million and, despite all efforts to reduce expenses, ICG posted a pre-tax loss of $16 million.

Despite this trend, ICG is resolved to operate on a profitable basis. A number of actions have already been taken which have reduced ICG's break-even point by 15 percent in the last two years. Contributing to this significant improvement are a 33 percent reduction in accident expenses, a 12 percent increase in fuel efficiency and restructured operations. We are also aggressively continuing the program to eliminate uneconomic branch lines. Finally, ICG has made very difficult decisions leading to a 34 percent reduction in its work force, including a 39 percent reduction in management employees, since early 1982. Because of these efforts and an improved economic climate, ICG experienced a return to profitability in 1984. However, due to the highly competitive environment, much additional work will be necessary to continue profitable operations in the future.

POSITION IN RECENT MERGER CASES

ICG's management faced difficult decisions in determining a position in the recent mega-merger cases considered by the Interstate Commerce Commission—the Norfolk & Western-Southern Railway merger, the Union Pacific-Missouri Pacific-Western Pacific case, and the pending Santa Fe-Southern Pacific merger. In each of these cases, the applicants themselves recognized that the proposed mergers would have significant adverse impacts on ICG as well as other carriers. However, with a fundamental belief that less regulation and government planning for the rail industry are essential, it was decided that opposition to these mergers was not in the interest of either ICG or the public.

Government policies have favored large carriers, resulting in incentives for railroads to merge. Thus, there now exists three major systems east of the Mississippi River—CSX, Norfolk Southern and Conrail—and two large systems—Burlington Northern and Union Pacific—operating essentially west of the river, with the potential for a third major western system—Santa Fe-Southern Pacific.

Notwithstanding ICG's corporate philosophy supporting less government involvement and our netural stance as to recent major railroad mergers, the ICG must now express serious concern about the proposed combination of Norfolk Southern and Conrail. What differentiates the proposed combination of Norfolk Southern and Conrail is that this marriage is largely one of convenience and is goverment-planned, as opposed to a combination based on market factors and forces. While not sounding the death-knell for the ICG, the potential revenue losses resulting from this proposal (combined with the cumulative impact of earlier mega-mergers), will narrow profit margins considerably, as ICG will have fewer carloads over which to spread its fixed charges. It will also result in the direct loss of employment as the Company responds to the heightened competitive threats. Moreover, the impact of this government-planned combination will fall on the ICG at a time when it is just beginning to turn the corner toward sustained profitability.

POSITION EXPRESSED TO DEPARTMENT OF TRANSPORTATION

When the Department of Transportation announced plans to sell Conrail, the ICG very quickly concluded that a sale to a non-railroad entity was in its best interest and in the best interest of shippers and consumers in the Northeast and Midwest. The reason behind this conclusion is simple. a free-standing, separately operated, Conrail will ensure the minimum degree of competitive rail service essential in that region. As presently constituted, Conrail already represents an enormous concentration of rail service previously operated by seven competing railroads.

Beginning very early in the bidding process, top executives from both the ICG and IC Industries, our parent corporation, have communicated ICG's concerns in several meetings with the FRA Administration and his staff. As Department of Transportation negotiations with several bidders progressed, we became increasingly concerned about the sale of Conrail to a major southeastern railroad. I conveyed ICG's position and concerns in writing to Secretary Dole on July 13, 1984. In addition, ICG sent a letter to the Department of Justice (January 22, 1985), in response to direct inquiries from it regarding the competitive threats that the proposed combination posed for ICG.

IMPACT UPON ICG

ICG's preliminary studies determined that the minimum annual revenue diversion resulting from a combined Norfolk Southern/Conrail would be $28 million (1983 dollars), with an additional potential of $23 million, for a total exposure of $51 million.

These figures derive from three types of diversion: (1) traffic from common points which could be converted to a Conrail/Norfolk Southern single-line movement; (2) traffic originated by Conrail or Norfolk Southern which could be routed to produce a shorter haul for ICG; and (3) traffic originated by ICG and destined to Conrail or Norfolk Southern which could be routed to produce a shorter haul for ICG.

We are nearing completions of a more detailed analysis of potential revenue diversions and will be pleased to provide the Committee with the results when available.

CONCLUSION

In summary, a merger of Norfolk Southern and Conrail will create monopoly power in the Northeast and in parts of the Midwest and South. This anticompetitive combination will create diversions of ICG traffic of a magnitude which will require ICG to reduce both service and employment. The Department of Justice has expressed a similar concern with the inevitable reduction in the competitive environment. The Department of Justice has required that, if a combination of Norfolk Southern and Conrail is consummated, the new entity must divest itself of specified lines to retain competiton in market areas affected by the transaction.[1] But, this alone will not preserve the competitive environment. Any carrier of combination of carriers purchasing lines from Norfolk Southern/Conrail must be able to compete with Norfolk Southern/Conrail on an equal, competitive footing. This condition is unobtainable, since the carrier acquiring the divested lines will not have direct access to industries within the network of main lines and branch lines that Conrail possesses.[2] The absence of access to stations on these lines would require the acquiring carrier and connections to negotiate with Norfolk Southern/Conrail for rates and routes which will be in direct competition with Norfolk Southern/Conrail's own single-line rates. Further, there have been no conditions stated or proposed which would require the merged system to establish or maintain competitive joint rates and routes after consummation of the merger. Therefore, the acquiring carrier may be totally denied access to Conrail stations.

With the combining of the bankrupt estates in the Northeast, Conrail maintains a government-sanctioned, pervasive position in that territory. If this market power which Conrail possesses is transferred to Norfolk Southern through inheritance, the potential for abuse is compounded. It must be expected that Norfolk Southern/Conrail will try to maximize its haul and revenue to the detriment of other carriers and shippers. Therefore, the proposed alternative of creating a competitive carier is seriously flawed.

Additionally, the Department of Justice's own realization of the anti-competitive problems raises another concern. Justice, in its decision, is concerned solely with maintaining competitive balance rather than the financial health of individual railroads and shippers.[3] While the sale of line segments called for in the Department of Justice's statement may maintain some semblance of competitive balance, there is no guarantee that regional carrier will be able to maintain profitable operations. Quite the contrary, a Norfolk Southern/Conrail combination may cause some railroad bankruptcies.

ICG believes that Conrail should remain an independent carrier, either through public sale of common stock or a sale to Alleghany Corporation. Either of these alternatives maintains the minimal necessary competitive environment. With the sale of Conrail to Norfolk Southern, a "Pandora's box" is opened which adversely influences the entire rail industry and shipping public. The Congress should disapprove the purchase of Conrail by Norfolk Southern. There are other viable alternatives which both resolve the government's concern in returning Conrail to the private sector and guarantee Conrail's longevity and independence.

We believe that the government must assume the responsibility, commensurate with its extraordinary role in the creation and operation of Conrail, to retrun this railroad to the private sector in a manner which treats all affected carriers, shippers, labor and communities as farily and equitably as possible.

STATEMENT OF JOHN H. BURDAKIN, PRESIDENT, GRAND TRUNK WESTERN RAILROAD CO.

This Committee has before it a momentous task—to insure that the sale of the Government's interest in Conrail not result in a significant reduction of rail competition in the Northeast and Midwest regions of this country, and to remedy existing anticompetitive conditions to the degree appropriate in the context of this sale process. I would like to thank the Committee for inviting me to present Grand Trunk Western Railroad Company's views on this important issue.

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[1] The Department of Justice proposal would essentially recreate the former Nickle Plate Road.

[2] Over 5500 stations would exist on a Norfolk Southern-Conrail system not served by any other railroad. Conrail alone presently serves a preponderance of the stations in Pennsylvania, New York, New Jersey and Delaware.

[3] As the Department of Justice proposal does not provide for competitive access from plants and facilities on regional railroads, a combined Norfolk Southern/Conrail could force non-served shippers out of eastern markets by refusing to establish and maintain freight rates comparable to those from local Norfolk Southern/Conrail producing points.

Before turning to the substance of my comments, I respectfully suggest that this Committee not attempt the impossible—to reach a definitive conclusion as to whether the Administration's proposal to sell Conrail to Norfolk Southern Corporation (Norfolk Southern or NS) will unacceptably diminish competition in the Midwest and Northeast. Today you will hear two panels of railroad witnesses with very different views on that and related questions. However, it is difficult enough to identify the important factual issues which are in dispute during the one or two days of hearings you have scheduled. To resolve them during this period would be more than any legislative body could realistically hope to achieve.

I would suggest an alternative mission. This Committee should determine whether the process of deliberations between now and the approval of any particular proposal or series of proposals will be fair to impacted parties, and whether it will lead to the resolution of these important disputed questions by objective fact finders with expertise in transportation, as well as in competitive, issues.

Grand Trunk believes that the process contemplated by the Administration's bill (S. 638) does not achieve those objectives. The Secretary of Transportation wants Congress to act on legislation that approves the sale of Conrail to Norfolk Southern before the details on that consolidation are finally negotiated and before the configuration of Justice Department mandated divestitures is known. The public and directly affected shippers and carriers have not and will not be given an opportunity to evaluate these plans under the process described in this legislation. This legislation gives the Secretary virtually unfettered and unreviewable discretion in resolving these uncertainties. Moreover, it would clothe the transaction with an antitrust immunity that will preclude private parties injured by this transaction, as well as the government, from seeking judicial scrutiny of this package.

It is essential that a thorough review process be completed before final Congressional action. If Congress commits itself to the Norfolk Southern transaction and the anticompetitive impacts are not adequately addressed by the divestiture plans or by the covenants agreed to by Norfolk Southern, there will be no turning back. Rail competition cannot be rekindled once its flame is extinguished because there are prohibitive barriers to new entrants.

The need for care at this stage, before the structure of the industry is reshaped, is further heightened by deregulation of the railroad industry that has taken place since the enactment of the Staggers Act of 1980. Competition and the free market are to be the regulators of the future, but if the structure of the industry provides no effective restraint on the exercise of market power, shippers and the public will be without recourse.

Grand Trunk recommends that this Committee request that an independent agency or agencies, such as the United States Railway Association (USRA) and the Interstate Commerce Commission (ICC), conduct an investigation open to all affected parties. That review process would resolve the disputed issues and would result in findings to be reported back to Congress before it takes final action on the Administration's bill. It will be said that DOT has already "investigated" the Norfolk Southern proposal and that another study will simply cause delay. To Grand Trunk's knowledge, no such study has been performed. Indeed, affected parties have not had access to it, or participated in the study process. Moreover, the details of the diverstiture plans have not been decided and thus could not possibly have been studied.

The investigation we are requesting can be completed by the time Congress returns from its August recess, leaving adequate opportunity for legislative action consistent with the findings and for the parties to consummate any approved tranaction before the end of the year.

I will now discuss the substance of Grand Trunk's concerns and attempt to identify those issues which must be resolved during this review process.

BACKGROUND ON GRAND TRUNK AND A SUMMARY OF ITS POSITION

Grand Trunk is one of a number of regional carriers that serve essential competitive roles in the key transportation markets impacted by the Norfolk Southern-Conrail merger. Grand Trunk operates over 1,500 miles of railroad in Michigan, Ohio, Indian and Illinois and directly employs over 4,000 workers in that region. Its affiliate, the Central Vermont Railway, Inc., operates over 350 miles of trackage in Vermont, Massachusetts and Connecticut and directly employs about 300 workers in those states.

Grand Trunk and other regional carriers will be devastated by the NS-Conrail merger, but the scope of the competitive impacts of the merger go far beyond the harm to individual railroads. Shippers and communities throughout the Eastern half of the United States will suffer a serious reduction in transportation alternatives, and will be confronted with one or at most two giant rail systems that will possess sufficient market power to dictate to all but the largest shippers monopoly prices for the services they choose to render.

Grand Trunk believes that the public offering proposal being suggested by my colleagues on this panel and others, or other alternatives which do not require the drastic restructuring implicit in the NS-Conrail merger, are far preferable because they do not pose the same risks to competition. Conrail is viable as a stand alone entity; there is no reason to select an option that threatens to destroy regional carriers and the transportation options that are available to shippers.

The Department of Justice study of the NS-Conrail merger identifies only a portion of the competitive problems caused by the transaction. Since it was designed to fix only the problems identified, the divestitute remedy prescribed by Justice is inadequate. If the NS-Conrail transaction is to be selected as the preferred option, it is essential that a divestitute plan be designed which can truly compete with NS-Conrail.

Grand Trunk has proposed two alternative plans to Norfolk Southern and DOT which it believes can satisfy the criteria set by the Department of Justice. Those plans have not been seriously considered because Norfolk Southern has no interest in divesting properties capable of providing effective competition. Based upon what we know to date about the divestiture plans preliminarily accepted by Guilford Transportation Industries (Guilford) and Pittsburgh and Lake Erie Railroad (P&LE), they offer no hope of providing long-term, viable competition to NS-Conrail, and are acceptable to NS for precisely that reason.

The covenants negotiated by the Department of Transportation (DOT) and Norfolk Southern are worthless. They provide only vague, temporary undertakings concerning the preservation of limited joint line routes and open gateways. If the protections were properly drafted they could provide shippers with some leverage in routing traffic even though they are otherwise captive to one railroad. However, the concessions negotiated by DOT offer no such leverage and joint routes with carriers the size of Grand Trunk would not be covered by the protections.

Before any definitive conclusions can be made about the anticompetitive impacts of NS-Conrail merger, or the adequacy of the remedies designed to correct them, more must be known about how Norfolk Southern intends to operate its combined system once it acquires Conrail. Several months ago we asked for this information from Norfolk Southern, and filed a Freedom of Information Act request seeking whatever studies or information DOT had in its possession. Those requests were refused. We can anticipate similar nondisclosure once the divestiture plans become finalized and Department of Justice begins its analysis.

Important issues of public policy which can seriously impact shippers, local communities and other carriers should not be conducted behind closed doors. The analysis of these plans must be done in a proceeding where minimal norms of due process are observed. The referral process suggested by Grand Trunk would achieve that result without imposing undue delay, and would also assure that these important issues receive the objective and expert analysis which they deserve.

AN NS-CONRAIL MERGER THREATENS COMPETITION

The proposed NS-Conrail merger will create a rail system of unprecedented size and market power. The combination will result in the largest transportation enterprise in North America with combined annual revenues of over $7 billion. NS-Conrail revenues will exceed the combined revenues of the eight largest motor carriers, one of which (North American Van Lines) is also about to be acquired by Norfolk Southern. The combined system will blanket a twenty-three state area with a network of over 32,000 miles of railroad. There will be over 5,500 stations on that system which are served by no other railroad and to which competitive access over joint line routes can be foreclosed at the whim of the NS–CR management.

The exclusive focus of the Department of Justice's competitive analysis has been the area west of Buffalo and Pittsburgh and east of Chicago and St. Louis where the Conrail and Norfolk Southern systems overlap and compete directly at stations they jointly serve. The Department did not consider the elimination of "indirect" and "source" competition.

What I call "indirect" competition relates to the ability of carriers which do not have direct access to a particular station or shipper to compete for business at that station either through a joint movement in conjunction with a third carrier that does serve that station, or through a joint line movement with the carrier serving that station over a route which short-hauls the serving carrier. For instance, Grand Trunk participates in movements to and from Michigan in conjunction with NS which are directly competitive with direct Conrail movements. That competition will cease once NS acquires Conrail. There are numerous other examples where shippers with traffic originating or terminating within territory served exclusively by Conrail, but moving to areas beyond Conrail's reach in competition with Norfolk Southern routes, will be left only with a NS-Conrail route. NS competitors will be forced from the markets in which they presently compete.

Source competition exists when carriers serve different points but the shippers at those points compete with each other. The carriers act as advocates for their respective shippers and compete with each other through pricing, development of innovative services and aggressive marketing in conjunction with the shipper on their line. When the two carriers merge the incentives are different, and this form of competition is lost.

The Department of Justice studied neither of these forms of competition and therefore could make no findings as to the degree they would be impaired by the NS acquisition of Conrail. But even in the region of the Department's principal focus, certain anticompetitive impacts were ignored. The Department measured competitive impacts by looking only at the common points served by NS and Conrail where one was already dominant in terms of the traffic volumes handled. Through this procedure they excluded from examination markets that may not have been dominated by NS or Conrail in the past, but where competition between them nevertheless existed and will in the future be eliminated.

In those markets Justice did study, it simply combined the historic traffic volumes handled by NS and Conrail, and then determined whether one or more other carrier historically handled a significant percentage of the business originated or terminated there so as to prevent the exercise of monopoly power. The problem with this static analysis is that it fails to take into consideration the traffic diversions that will occur as a result of the merger. NS and Conrail, once merged, will be able to do things together that neither could do alone in the past. A dynamic analysis, which takes into account the additional traffic diversions which will occur as a direct result of the merger, is the accepted method for measuring these impacts in merger proceedings at the Interstate Commerce Commission. Outside the transportation context, I am advised that courts require that the future competitive abilities of the merging companies by evaluated as well as their historic market shares. The Department of Justice specifically declined to review these impacts in its evaluation of the NS-Conrail merger.

The trouble with disregarding such impacts is that the analysis assumes that regional carriers like Grand Trunk will continue to serve as a restraining force in markets where they historically played a role. Speaking for Grand Trunk, the traffic diversions resulting from the merger may so weaken us that we will be prevented from continuing to offer truly competitive service in those markets.

I am not an economist or an expert in competitive analysis, but the studies performed by consultants retained by Grand Trunk report, on a preliminary basis, impacts beyond those identified by the Department. Commodities moving to consumers and from producers in cities like Cincinnati, Columbus, Buffalo, Detroit, Washington and St. Louis, not to mention scores of smaller markets, will be dominated by NS-Conrail. Yet these cities are not identified on the Department of Justice's list of endangered markets.

The Department of Justice nevertheless concluded that the sale to NS "would have a significant adverse effect on competition" and that "without appropriate divestitures * * * would violate both Clayton Act and Interstate Commerce Act merger review standards." Unfortunately, the divestiture remedy prescribed by the Department addresses only the problem areas its inadequate analysis identified. The condition attached to Norfolk Southern's memorandum of intent with DOT—even if a viable divestiture plan were to result from it—would not counterbalance the full scope of injury to competition that will inevitably result from the transaction.

Similarly, the covenants negotiated between Norfolk Southern and DOT are inadequate on several counts. Secretary Dole has made much of these covenants in her arguments against the public offering alternative, but upon examination they prove to provide benefits that are at best illusory.

For example, the Secretary negotiated a covenant designed to reestablish joint line routes closed by present Conrail management. This is a laudable goal, but the provision fails miserably to create a long term, enforceable requirement of benefit to Grand Trunk or similar carriers. The provision lasts for only five years, and would not benefit carriers like Grand Trunk with more than $300 million in gross revenues. Competition is competition, and it is illogical to limit the period during which it should flourish, or to distinguish among carriers providing the competition based upon their size.

Reopening gateways and reestablishing routes is a complicated problem to be sure. However, the covenant agreed to by Norfolk Southern does not begin to grapple with the difficult issues. Its terms are vague, and it does not establish definite or enforceable standards. Since it is an arrangement between two other parties, it is not clear what rights of enforcement the intended beneficiaries would have.

Grand Trunk cannot accept vague platitudes contained in a contract between two other parties. We will propose for your consideration an amendment to the Administration's bill which will secure indirect competitive access to the stations served in territory dominated by NS-Conrail.

The Administration's proposed bill has a further deficiency. Section 104(a) of S. 638 provides that: "[I]mplementation of the Secretary's Plan [defined as the Memorandum of Intent between DOT and NS and the divestitures outlined in the Department of Justice letter] and coordinated operation of [Conrail's] properties with those of Norfolk's Southern Corporation * * * is deemed approved by the [Interstate Commerce] Commission under Chapter 113 of title 49, United States Code."

The bill does not come out and say it, but the effect of this language is to confer antitrust immunity. Transactions approved by the ICC automatically receive antitrust immunity under 49 U.S.C. § 11341, but not without a full and detailed analysis by the Commission. That analysis includes a due process hearing with rights of discovery and cross examination, and the opportunity to submit opposition and rebuttal evidence. Such investigations are permitted by statute to take up to 31 months from the time the detailed application submitted by applicants is accepted by the ICC.

None of the prerequisites to granting immunity have occurred in this case. Impacted parties, including Grand Trunk, have not the vaguest idea how the NS-Conrail system will be operated because we have never been provided with more than the most superficial public relations pieces on the transaction. Most important, the decision making process of DOT has not been conducted in the open or with modicum of due process. DOT and Justice have engaged in closed discussions with various parties, but have treated all submissions to them, as well as their own internal analyses, as confidential. The antitrust immunity should not be conferred under these circumstances.

IF NS-CONRAIL IS TO BE APPROVED, CONGRESS MUST INSIST UPON CREATION OF A SOUND DIVESTITURE PLAN

Strong medicine—not a placebo—is needed to rectify the anticompetitive problems associated with the NS-Conrail merger.

During the decade of the 1960's when Conrail's predecessor railroads were involved in merger proceedings, the Justice Department asserted that a long standing affiliation between the Pennsylvania Railroad (PRR) and the Norfolk and Western Railroad (N&W) created an unacceptable concentration of market power in the region, and that PRR should be required to divest entirely its controlling interest in the N&W. The ICC agreed, and ordered the divestiture. Much has happened in the intervening years, including a dramatic reduction in the number of independent rail competitors throughout the Northeast and Midwest. However, approval of a consolidation that links N&W's even larger successor (Norfolk Southern) with PRR's successor (Conrail) is more offensive to the principles underlying the antitrust laws today than it was during the earlier proceedings.

This time the Justice Department has recommended a divestiture plan that is more limited than it required twenty years ago, and as I have previously explained it does not go far enough. Nevertheless, the Justice Department letter sent to Secretary Dole does set tough standards for those divestitures which it requires.

The entities acquiring the divested properties must be "* * * capable of providing long-term, viable, and competitive rail service" in the rail corridor bounded by Pittsburgh and Buffalo in the east and St. Louis and Chicago in the west. They must possess "* * * the managerial, operational and financial capability necessary to compete effectively, and to remain a viable entity providing long-term rail service along the designated corridor."

Even under the Department of Justice's inadequate identification of anticompetitive problems, the so-called "problem markets" involved traffic which accounted for $516.1 million in freight revenues. The divestiture plan in the Department's view should "resolve at least $371.4 million of the potential problems."

This is a tall order when it is remembered that the carriers acquiring the divested properties will be competing against a system with enormous financial resources, a top flight physical plant rebuilt with billions of dollars of taxpayer money, and large traffic volumes that will permit frequent train schedules in the same corridors as the divested lines.

Several months ago, Grand Trunk and the P&LE proposed a system of divested lines to Norfolk Southern and DOT which had a chance of meeting these criteria. It was called ProRail. It provides for access to impacted markets over lines which were selected because they have the following characteristics:

1. An adequate traffic base to ensure long-term viability and to render satisfactory frequency of service;
2. The ability to offer competitive schedules on or near the first day of operation so that the traffic and commercial relationships would not be forever captured by NS-Conrail;
3. Need only minimum roadway capital expenditures for new connections and upgrading;
4. Permit participation of regional carriers and the incentive to promote mutual cooperation; and
5. Cause the least disruption to the operations of the NS-Conrail system.

The lines we identified using these criteria never received serious consideration because, under the Department of Justice letter, Norfolk Southern has been given the responsibility of proposing a divestiture plan. Naturally, Norfolk Southern has not been interested in discussing high quality lines with access to traffic in volumes essential to creation of a viable system. Instead, they identified a set of surplus lines, some of which were slated for abandonment, and were unwilling to discuss alternatives because other carriers found these lines to be acceptable. This is a classic case of the fox selecting the guardian for the chicken coop.

Nevertheless, Grand Trunk has developed a detailed business plan which demonstrates the ProRail can satisfy the rigid criteria set by the Department of Justice. With the announcement by DOT that there has been tentative agreement for certain divestitures to P&LE and to Guilford, Grand Trunk has set the ProRail proposal to one side. However, if it is determined that the tentative divestitures to P&LE and Guilord cannot achieve the level of service and profitability necessary to compete with NS-Conrail, Grand Trunk is prepared to move forward alone or in conjunction with other regional carriers to put ProRail together.

Grand Trunk has not sat idly while P&LE and Guilford have attempted to define their plans. Within the last week Grand Trunk has proposed to NS an alternative divestiture plan designed to dovetail with the P&LE and Guilford divestiture plans. We call this plan our West End Project. It would address the competitive problems west of Toledo and Ft. Wayne and bring Grand Trunk's traffic, managerial and financial resources to bear on the divestiture issue. As I will discuss below, the divestiture plans outlined by Guilford and P&LE are particularly weak in this region, and this alternative proposal can address those weaknesses.

The West End Project would provide direct access from Detroit and Toledo to the St. Louis and Chicago gateways via high quality Conrail and NS lines intersecting at Ft. Wayne, Indiana. These lines would be acquired outright or be jointly operated by Grand Trunk and NS-Conrail. Unlike the Guilford plan, this is territory Grand Trunk knows and in which it is capable of providing a credible competition to NS-Conrail.

These acquisitions would address the Department of Justice's concerns for preserving a competitor at points in this region, but based upon our preliminary analysis would not assure compliance with the equally important criterion that the acquirer provide "long-term, viable, competitive rail service" in that affected transportation markets. To address that concern we would propose to acquire the Conrail lines in Michigan.

The lines in Michigan have been said to be beyond the scope of the Justice Department's requirements. We disagree because the Department has identified Michigan counties as among the impacted counties. In addition, we believe that Norfolk Southern's acquisition of Conrail will have adverse consequences on competition throughout Michigan because it will lead to the demise of Grand Trunk, leaving only two rail competitors throughout Michigan. Our proposal would preserve two strong competitors throughout Michigan while preserving NS-Conrail's presence in the Detroit industrial market.

The key significance of the Michigan lines, however, is traffic. The traffic contributed by these Michigan lines is essential to the satisfaction of the Justice Department's criteria for viability and competitiveness.

I believe that competition throughout vast areas of Michigan will be adversely impacted by the NS-Conrail merger. But even if I were to accept the narrow definition of competitive impacts adopted by the department of Justice, I have been advised by counsel that it should not preclude these Michigan lines from becoming part of the divestiture plan. In its 1979 report to the President, the National Commission for the Review of Antitrust Laws and Procedures (known as the Shenefield Commission), on which Senators Metzenbaum and Kennedy served, was critical of partial divestitures, limited strictly to so-called "offending assets," which failed to result in creation of a viable entity. "[T]he view more consistent with the purposes of the antitrust laws is that the remedy ought to bring about "workable competition." Divestiture should include assets sufficient to create a viable entity or attract a procompetitive purchaser. If the "offending" assets are insufficient, the court should order additional, "non-offending" assets divested."

Grand Trunk is willing to consider methods for achieving the viability of the divestiture plans other than through conveyance of the lines in Michigan. However, the proposals placed on the table by Guilford west of Toledo do not come close to satisfying the Justice Department criteria for "long term, viable, and competitive rail services to locations along the corridor." For that reason Grand Trunk's West End Project deserves serious consideration.

To provide effective competition with a giant rail system that will be operating ten to fifteen trains per day in each direction between major cities in certain corridors inditified by DOJ, the carriers operating the divested lines must have a strong traffic base and a modern physical plant. The plans offered by Guilford and P&LE fail miserably on both scores, particularly west of Toledo.

The meager traffic base of the Guilford and P&LE plans is not adequate to provide daily through freight train service within the corridors identified by the Department of Justice. Our preliminary traffic analysis shows that the Guilford and P&LE divestiture plans will be able to attract on a combined basis no more than 132,000 carloads of freight from the shippers located along the lines to be acquired and from shippers which Guilford and P&LE presently serve that have traffic which can be routed over the divested lines. In certain corridors they will not be able to justify daily train service.

For instance, traffic volumes to and from St. Louis will permit Guilford to operate at most five short trains per week in each direction. Annual traffic densities expressed in million gross tons per mile is a useful measure of viability. The ICC classifies lines with less than 3 million gross tons per mile as feeder lines. Guilford's "main line" to St. Louis will have only 2.1 million gross tons per mile and will be in no position to provide effective competition to NS-Conrail in this corridor. A similar problem exists in the Chicago corridor.

The density of traffic originations is another measure. On a combined basis, the P&LE and Guilford plans involve lines with less than one half the national average of carload originations and about one third of what the Norfolk and Western lines in the region generate. The sparcely populated lines to be acquired by Guilford west of Teledo are the principal reason for these undesirable ratios.

On the traffic Guilford and P&LE will be able to attract to their expanded system, they will be subject to short hauling by NS-Conrail or CSX. However assuming Guilford and P&LE retain *all* 132,000 carloads, and assuming further that they receive the same avergage revenues received by NS and Conrail during 1983 (i.e. no short hauls by NS-Conrail), the combined gross freight revenues to be generated by Guilford and P&LE would not exceed $106.5 million per year.

These estimates are to be compared with the Traffic estimates for the ProRail system which were computed using the same traffic model. ProRail would attract 354,000 carloads with $359 million of gross freight revenues. ProRail is profitable at these levels, but is by no means a bonanza. The traffic benchmark set by the Department of Justice for the divestiture plans, mentioned previously, was that the plans should compete at least $371.4 million of the $516 million of traffic that was originated or terminated in problem markets. It is clear that the P&LE and Guilford plans do not come close to this standard.

The P&LE and Guilford plans also fail the other critical prerequisite for viability: adequate facilities, requiring minimal capital expenditure and capable of providing efficient service. Again, this is principally a problem on the lines west of Toledo. Guilford has agreed to acquire the cast-offs from the NS-Conrail system which cannot hope to satisfy this prerequisite. In many cases the trackage is in poor condition and the access to impacted markets is indirect or over trackage rights where NS-Conrail dispatchers will control their competitor's freight operations.

The line to be acquired for access to the St. Louis gateway is truly a streak of rust for 133 miles east of Frankfort, Indiana. This segment has mostly second hand, non-control cooled rail weighing 90 and 100 pounds per yard which must be replaced with continuous welded rail weighing not less than 115 pounds per yard. On the segment west of Frankfort, NS has already slated 163 miles for abandonment. Bridges along the right of way are subject to weight restrictions that prevent use of modern six axle diesel locomotives over this route.

The maximum authorized freight train speed on existing NS and Conrail major freight routes in the impacted corridor is mostly 50 and 60 mph for manifest trains and 70 mph for certain dedicated intermodal trains. To get Guilford's line to St. Louis in shape so that it can permit an authorized speed of 49 mph, our consultant estimates that a minimum of $45 million must be expended for new rail, ties, ballast and related materials. Conrail management has estimated that the investment in this line necessary to operate high speed service comparable to that rendered by NS-Conrail would be $110 million.

Other segments to be acquired require lesser, yet still significant capital expenditures. Even if the lines were given away, one wonders how expenditures of the magnitude required can be justified given the scarce resources of the carriers involved and the existence of superior lines on NS-Conrail.

ProRail and our West End Project contemplate coordination and cooperation among the regional carriers. Conversely, Guilford and P&LE have not announced any cooperative efforts or plans for coordinated operations and service. Grand Trunk would be willing to coordinate its services with any system made from divested lines, provided it is capable of rendering competitive service. Our shippers will not tolerate inferior service, and we would jeopardize our participation in the traffic if we were to promote such routings. Unfortunately, the present proposals by Guilford west of Toledo will not provide service we can promote. Therefore, it can only be assumed that the Guilford and P&LE expanded systems under their proposed divestitures would be operated as independent, competing entities, and that Guilford would also be competing with Grand Trunk, especially on traffic moving between Chicago and Buffalo.

Clearly, a satisfactory divestiture plan has not been identified to date. It is for that reason that a more deliberate investigation must be undertaken to determine whether such a plan or plans can be fashioned. To pass legislation authorizing the sale of Conrail to Norfolk Southern before that process has been completed involves risks too great for Congress to take.

CONCLUSION

At the outset of my comments I expressed the view that this Committee should not attempt to do more than it is capable of doing. I have taken positions on competition and the viability of the divestiture plans which are certain to be disputed by others testifying today. However, the level of discussion, by necessity, is at the broadest level of generality. Both sides to this dispute should be forced to come forward with their studies and their experts before an independent agency competent to determine the true facts.

It is too early to begin that process because as of this date very little is known about the proposals advocated by Norfolk Southern and the Administration. That information should be made available to affected parties, with adequate precautions taken to protect commercially sensitive date.

The lack of information or an opportunity to evaluate the impacts of the Administration's proposal are problems raised not only by Grand Trunk. The Executive Vice President of the National Industrial Transportation League has written a letter to Senator Danforth expressing the following concerns of its shipper membership:

"* * * I would like to convey the growing apprehension being expressed to me by League members about the expedited handling of the Conrail sale which could foreclose the opportunity for those directly affected to provide meaningful input in this process.

"* * * We maintain that shippers have not had sufficient opportunity to analyze all the options available since the Secretary of Transportation announced the decision to sell Conrail to the Norfolk Southen. Lack of meaningful information on rail lines to be sold, financial matters, and other issues precludes timely and constructive evaluation of the issues and input to your Committee. The rush to judgment on this matter is unnecessary. A full analysis and review of the sale process by appropriate Congressional committees should be made. Legislation should not be progressed until shipper concerns are met."

I subscribe to these sentiments and earnestly request that the Committee require that the sales transaction and divestiture plan be subjected to the scrutiny of a review by an independent agency qualified to resolve these complicated transportation issues.

STATEMENT OF ROBERT CAPOZZI, PROJECT DIRECTOR, CITIZENS FOR A SOUND ECONOMY

Mr. Chairman, members of the committee, thank you for this opportunity to articulate Citizens for a Sound Economy's (CSE) views on the sale of Conrail.

My name is Robert Capozzi. I am Project Director of CSE's Public Sector Privatization Alliance. CSE is a newly formed public-interest group dedicated to returning economic decisionmaking to citizens. With an active membership of 40,000 citizens, CSE promotes policy and educational initiatives in the areas of privatization of government services, Social Security, international trade, and tax reform.

Let me make clear that we support the general notion of privatizing Conrail. Two overwhelming arguments for this are, first, the government should not be in the rail freight business; and second, the taxpayers should have to pay no more than the $3.3 billion they have already subsidized Conrail for.

Although we prefer not to belabor the point of whether or not the government should have bailed out Conrail in the first place, let the record show that our view is that it should not have. We believe that market forces and individual choice, not government, should determine which goods and services are demanded and supplied. By bailing out Conrail, the government distorted the market forces, thereby crowding out a host of other, more economically efficient, business enterprises.

With that in mind, we believe it is imperative that Conrail be sold as soon as possible. For our part, the question is not so much whether it should be sold, but rather how this divestiture should be carried out.

There have essentially been two positions staked out on the divestiture question. The first, put forth by Secretary Dole and the Department of Transportation (DOT), is that Conrail should be sold to one nd only one corporate entity. The latter, and, in our view, the superior position, is that there should be a public offering of all Conrail stock. This view has most recently been articulated by Senator John Heinz.

Our view is that the DOT's position is, while understandable, essentially unsound. Similar to the meddling parent who resists a child's leaving home, DOT has attached a series of strings to the divestiture deal. Specifically, these include several five-year clauses, like: (a) a continuation of Conrail's business and services substantially as is; (b) maintenance of a controlling interest of the railroad; (c) specification of certain "adequate" capital investments; (d) creation of a threshold level cash balance before dividends can be paid; and (e) a stipulation that, in the case of liquidation of unprofitable rail lines, sale of such lines at 75 percent of liquidation value.

While DOT asserts that these covenants are in the public interest, we believe that such dirigistic clauses only serve to emasculate the new management's ability to react to a changing economic climate. Indeed, DOT admits that the sale price of $1.3 billion is substantially less than Conrail's book value of approximately $4 billion. The $2.7 billion differential is essentially the cost of these covenants to the taxpayers. In essence, this represents yet another subsidy to Conrail.

DOT argues that these covenants are necessary in order to safeguard against Conrail's failing back into bankruptcy. This line continues that if Conrail did once again become insolvent, the federal government would have to step in and take over. We rejects this conclusion. If this is true, then it logically follows that such covenants could be placed upon *all* industry, or at least all firms which, were they to go bankrupt, would have to be bailed out by the federal government. Our view is that government's proper role is not to bail out failing industry under any circumstances. The cost of socializing these bankruptcies can only hurt the public interest.

There is no indication that the DOT has the expertise to dictate future sound management decisions, or the standards for those decisions. Conrail's success in coming back to profitability after the bail-out has less to do with federal government management and more to do with the current management under L. Stanley Crane.

The lesson of the British Telecom (BT) privatization is valuable here. This entity, once a government-owned and -operated enterprise, is in the process of being sold off in a public offering. It is arguable that BT is a more fundamental element to the British economy than Conrail is to the American one, yet the British, who have a more accomplished privatization record than does the United States, have opted for the public offering route.

Nonetheless, we believe that of the three options regarding Conrail, (a) the DOT plan, (b) the Heinz plan, and (c) the status quo, the third is clearly inferior. From the perspective of the broad public interest, the Heinz plan is superior and the DOT plan is a strong second. In short, sub-optimal privatization is superior to the continuation of Conrail as a governmental entity.

Thank you again Mr. Chairman for this opportunity to present the citizens' view on this crucial public question.

STATEMENT OF THE CHICAGO SOUTH SHORE AND SOUTH BEND RAILROAD

My name is John A. Darling. I am the Chairman and Chief Executive Officer of the Chicago South Shore and South Bend Railroad, a regional railroad located in northern Indiana.

The Chicago South Shore and South Bend Railroad appreciates this opportunity to supplement the Senate Judiciary Committee record on S. 638 and the proposed sale of the Consolidated Rail Corporation's common stock by the Department of Transportation. The South Shore's concerns address the decrease in competition that will occur in St. Joseph County, Indiana, as a result of Conrail's acquisition by the Norfolk Southern. St. Joseph county is one of the several counties the Justice Department determined have a competitive revenue problem of more than $2 million. The Justice Department did not, however, include St. Joseph County as one of the mandatory divestitures listed in that Department's letter to Secretary Dole dated January 29, 1985.

The South Shore is willing and able to purchase Norfolk Southern or Conrail lines in St. Joseph County and thereby preserve the existing level of rail competition in that county. I would emphasize that the South Shore's proposed acquisition would meet all the other standards contained in The Justice Department's letter of January 29, 1985 to Secretary Dole. However, Norfolk Southern has refused to discuss with the South Shore the sale of any lines in St. Joseph County because the latter county is not on the list of mandatory divestitures contained on page 1 of attachment A of Justice Department's Janaury 29 letter. The Norfolk Southern's reluctance to sell any assets beyond those absolutely required is understandable as a matter of Norfolk Southern business strategy. The South Shore does not believe that such a strategy is in the public interest when a competitive problem is a matter of public record.

St. Joseph County includes City of South Bend and is one of the four most populous counties in Indiana. In fact, in total populations and number of manufacturing plants, St. Joseph is almost as large as Allen County, Indiana, a county slated for mandatory divestiture. St. Joseph County is an example of how the relatively broad approach to competition by the Justice Department overlooked a possible divestiture to a regional railroad that is commercially and technically feasible. Yet because the DOT-Justice agreement is "cast in stone," there will be no divestitures in St. Joseph County or similar counties unless the Congress so directs. South Shore therefore recommends that the Congress modify the Department of Transporation's bill to provide that as long as the divestiture of additional problem counties meets the standards contained in the Justice Department's letter of January 29, 1985 to Secretary Dole, the Norfolk Southern would be required to do so.

MOBAY CHEMICAL CORP.,
Pittsburgh, PA, February 22, 1985.

DEAR SENATOR: Mobay Chemical Corporation produces and sells polyurethane and various industrial, organic and agricultural chemicals. Our sales were approximately 1.6 billion dollars in 1946. We ship and receive over three billion pounds per year from eight plants. About 40 percent of that volume moves by rail. Three of our major plants, New Martinsville, West Virginia, Baytown, Texas and Kansas City, Missouri, depend heavily on rail service.

Mobay does not oppose the sale of Conrail to the Norfolk Southern, and we do support the decision as made by the Secretary of the Department of Transportation. This does not mean that we support or oppose any of the three final contenders or the public offering—simply that we believe that the DOT has properly carried out their assignment to select a buyer. We do believe that studies and recommendations from the Department of Justice and Goldman-Sachs & Co., if implemented, will properly deal with concerns about competition and economic viability.

Three points can be made specific to Mobay:

We are not concerned about loss of competition. While we do not originate any significant traffic on either railroad, we do terminate about 95 thousand tons per year on Conrail and about 30 thousand tons per year on Norfolk Southern. There is little or no Conrail-Norfolk Southern competition in our routings. Incidentally we are "captive" at two major origins, but our experiences since the Staggers Act have been positive, and we do not consider this to be a major problem. Adequate competition is usually provided by other modes, or by competing suppliers on other railroads.

The proposed sale would appear to provide a financially sound railroad with resources to weather inevitable dips in the economic cycle, or further deindustrialization of the northeast. This should give the best assurance that future, long-term rail service will be available in this area.

We have no reservations about Norfolk-Southern's ability to provide efficient, effective rail service.

Thank you for consideration of our comments.

Very truly yours,

R.A. CHRISTMAN,
Director, Customer and Distribution Services

CONAGRA, INC.,
Omaha, NE, April 3, 1985.

Senator J.J. EXON,
Hart Senate Office Building,
Washington, DC.

DEAR JIM: This is to follow up the discussion Don Stone, Paul Korody and I had in your office recently concerning the proposed sale of ConRail. You asked for some specific figures about the grain we ship from Nebraska. The short answer is that ConAgra's four flour mills in Pennsylvania collectively utilize 12 million bushels of wheat annually, approximately 50 percent of which comes from Nebraska. More details are included in the information below regarding ConAgra's position.

It is ConAgra's position that ConRail should be returned to the private sector in a way that would strengthen rather than weaken the nation's transportation system. The sale of ConRail to Norfolk Southern, a parallel carrier, would clearly be anticompetitive and a great disservice to shippers and the public in the affected territory. Further, it is our position that the Justice Department conditions did not go far enough to guarantee long-term competitive transportation service in the East. The divestitures ordered by the Justice Department are such that the power of the combined Norfolk Southern-ConRail System will preclude sustainable operations over those segments. As a practical matter, there is little hope that those lines could survive the powerful monopoly of Norfolk Southern over the long term.

ConRail and the large eastern markets which it serves with its vast transportation network are vitally important to this company and the thousands of customers we serve. ConAgra operates four flour mills in the state of Pennsylvania. Three of those plants, which are located at Martins Creek, Treichlers and York, are served exclusively by ConRail. The fourth plant is at Red Lion and is not a rail served facility. The plants at Martins Creek and York process wheat that is produced in Nebraska, Minnesota, North Dakota and related areas and is routed over western lines to Chicago thence ConRail to those locations in 50 or 60 car unit train service. The plant at Treichlers receives grain by both ConRail and truck, while the Red Lion facility is strictly a truck oriented operation. Collectively, the four plants utilize 12 million bushels of wheat annually, approximately 50 percent of which comes from Nebraska. All four milling locations operate in a well-balanced competitive environment today. Their finished products are marketed in areas where they compete head-to-head with flour mills served by Norfolk Southern. That competitive balance will be destroyed if Norfolk Southern is authorized to acquire the ConRail System.

In addition to the points we made in our position paper during our recent visit, there are other significant concerns which we will briefly mention:

The factual basis for Staggers is competition. Legislation should preserve competition so that Staggers has an opportunity to work. Deregulation and railroad monopolies cannot coexist.

The sale of ConRail to Norfolk Southern could possibly be one of the most anticompetitive mergers in the history of the transportation industry. Consolidation of parallel carriers with overlapping trackage creates excessive market power and this, in turn, translates into higher shipping costs which are ultimately passed on to consumers.

The modest transfer of substandard line segments to Guilford and P&LE does not constitute competition for Norfolk Southern. Guilford's and P&LE's route structures would be circuitous, inferior and have track speeds far under those of the Norfolk Southern System.

Mini-regional carriers such as Guilford and P&LE cannot possibly match the marketing strength of what would be the nation's largest railroad with a 30,000+ mile system.

ConRail, as we know it today, is a lean, rationalized, profitable, well managed railroad. While we share Congress' concern that ConRail be disposed of in a way that ensures its survival as a strong viable carrier, we are concerned that the Department of Transportation has not given sufficient weight to the competitive issues, nor to alternative disposition that would maintain ConRail as a separate entity. Alternatives to preserve ConRail as a separate entity should be explored to the fullest extent. Your cooperation in this matter will be greatly appreciated.

I hope this information will be useful.

Sincerely,

MARTIN G. COLLADAY.
Vice President, Public Affairs.

STATEMENT OF JAMES P. DEEHAN

My name is James P. Deehan. I am employed by Union Camp Corporation as its General Manager, Distribution & Transportation, at 1600 Valley Road, Wayne, New Jersey 07470.

Union Camp is a major manufacturer of paper products, lumber and chemicals with its heaviest production facilities—world class paper mills—located at Eastover, South Carolina; Franklin, Virginia; Montgomery, Alabama and Savannah, Georgia. Union Camp operates 68 plants in 28 states.

With 12 manufacturing production facilities located on Conrail and another 19 production facilities on the Norfolk Southern Railroad, Union Camp has a strong and direct interest in Congress' disposition of Conrail. This is particularly important since the Department of Transportation has recommended Conrail be sold to the Norfolk Southern Corporation. The location of major paper mill production in the southeast and with the important customer markets in the northeast, results in a substantial flow by rail of paper production from the south to customers served by both Norfolk Southern and Conrail. In order of magnitude, of the three railroads that receive the most freight revenue from Union Camp, Norfolk Southern and Conrail are two of those three railroads.

It's been Union Camp's preference to seek solutions to the Conrail problem through expanding rail competition in the northeast with acquisition of specific lines of Conrail, by its connecting railroads. Multiple rail ownership of all of Conrail's tracks would provide improved competition to the major markets in the northeast.

Another alternative is an independent Conrail, either through acquisition by a non-railroad operating company such as Alleghany, or through a public stock offering, provides shippers with the maintenance of the rail-to-rail competition in existence today.

There is minimum support for the multi-railroad disposition of Conrail. At the same time, an independent Conrail does not appear financially feasible as a successful alternative.

Such an analysis highlights the reality of the situation. A well-managed, financially sound railroad, such as Norfolk Southern, does have the capability to offer stability over the long term for the railroad situation in the northeast. There is, however, one major disadvantage: That is a merger between two of the three railroads serving all of the industry east of the Mississippi River. The sole remaining significant railroad is the CSX System.

Norfolk Southern's acquisition of Conrail without a requirement to maintain in place all rates, routes and gateways, would be such a dramatic reduction in competition that it would lead to major market distortions. For that most important reason, there must be assurances from Norfolk Southern Corporation agreeing to the maintenance of all competitive options, at origin and destination, which are now available to shippers using Conrail's services.

This shouldn't be an insurmountable problem. The synergism of Norfolk Southern's management and their operating skills, coupled with the greatly improved well run Conrail, no doubt, will result in significant operating efficiencies and cost savings. This is where the public should benefit, if this merger is approved. The merged (Norfolk Southern-Conrail) system would be in a position of attracting additional business to its single-line service by offering lower rates to apply via Norfolk Southern-Conrail. A shipper would then have the alternative, or option, of the new system's lower rates and, presumably, superior service; or, continue to use the joint rail routes and rates that are available today. At the same time, the railroads participating in the joint routes, of necessity, would feel the competitive pressure of the marketplace, to improve the cost of providing the joint railroad service in order for them to continue being competitive with the new single-line system.

It's important for members of Congress to be aware that competition in the railroad industry is unlike competition in all other businesses. No manufacturer is in a position to unilaterally require customers to use or purchase solely from any particular plant. Union Camp competes in the marketplace on the usual criteria: The quality of its product, customer service, price and a reputation for integrity and dependability. All of these attributes are evaluated by the customer in order for Union Camp to participate in that customer's business.

Railroads, on the other hand, are in a unique position of limiting options available to its customers. That is why in an issue so important to a major segment of the country, that a way be found to preserve and maintain railroad service for the long term, but in such a manner that will allow the free enterprise marketplace to function.

We greatly appreciate the Committee's consideration of this important subject. We thank you for providing us this opportunity to express Union Camp's views.

STATEMENT OF PETER C. GOLDMARK, JR., EXECUTIVE DIRECTOR, THE PORT AUTHORITY OF NEW YORK AND NEW JERSEY

The Port Authority is a bi-state agency created in 1921 by the States of New York and New Jersey with the consent of the United States Congress. Its purpose was, and is, to undertake port and regional improvements in the area of transportation, economic development and world trade that contribute to promoting and protecting the commerce and economy of the Port District, an area of about 1500 square miles in both states centered about the New York Harbor. The Port Authority developed and operates Port Newark-Elizabeth, the nation's largest container terminal complex, and the Red Hook Container Terminal in Brooklyn, which contribute to New York Harbor being the number one port in the nation in the value of its oceanborne foreign trade cargoes. We also manage the railroad container drayage program for the City of New York which equalizes drayage for container terminals located in New York. The Port Authority is also actively involved with the two states in promoting and improving rail freight service for the New York-New Jersey region. New York/New Jersey is Conrail's number one port and Conrail is virtually our only major railroad. We thus have a vital interest in Conrail's future.

Our primary concern regarding the proposed sale of Conrail is the relationship between the future of Conrail and the fate of import/export traffic in the New York/New Jersey region. While the large majority of Conrail's traffic base is comprised of domestic shipments, import/export traffic nonetheless has a significant and growing share of the region's rail activity. It is traffic for which we must compete with other ports. Rail service to our port facilities is an integral element in our strategy to maintain the Port of NY/NJ as the load center on the East Coast. By the term "load center", I am referring to the trend of larger ships carrying over 4,000 20-foot container equivalents calling at fewer ports, with non-load center ports being served by truck or barge. The Port of New York/New Jersey was the first to introduce containerization, though other ports have since made in-roads into our dominant position. Much is at stake in this initiative since the port industry accounts for some $14 billion in economic activity, $4.2 billion in wages, $500 million in state and local income and sales taxes, it directly generates over 100,000 jobs in the New York/New Jersey Region, with a regional employment impact almost double that.

Our load center strategy is driven by the need to lower costs, particularly in light of further deregulation and the resulting increase in competition between ports. This initiative includes terminal modernization, harbor dredging, adequate storage capacity, and improved access to inland transportation. The Port Authority has the responsibility to lead this effort and we are prepared, through our Bi-State Port Plan, to meet this responsibility by, among other things, making the investment of some $400 million that will be required. In addition to facility investments, the Port Authority is actively, working to reduce costs through our extraordinary action before the Federal Maritime Commission to work out a more acceptable arrangement on tonnage assessments that had disadvantaged our port. We are extremely hopeful that efforts like this will further strengthen our competitive position.

Rail service is a significant factor in this effort to reduce costs. Because of the Shipping Act of 1984, rail service will become increasingly competitive with truck, with the result that it should become an even more important factor in port selection. In the midst of this, we face significant potential changes in what has been a close and productive relationship with Conrail. Conrail's services are far superior to a decade ago. Our port suffered terribly from poor service in the final years of Conrail's bankrupt predecessors and, at all costs, we want to avoid that kind of instability again in our rail network. Conrail Chairman Stanley Crane and his staff deserve substantial credit for this turnaround and the excellent reliability, frequency and transit time of Conrail's intermodal operations. Nonetheless, much still needs to be done and we will be seeking even more in the future in innovative and attractive rates and services from whoever acquires Conrail.

In light of what is at stake, and because of inadequate information relating to what the specific plans and intentions of the various parties are, we are not yet in a position to favor one of the options for the sale of Conrail over another. Neither do we see a consensus among shippers at this point. A number of them favor either a public offering or doing nothing for a few years, though many favor a sale to Norfolk Southern. Some shippers have also come forward to endorse CSX's proposal of several months ago for a controlled breakup of the Conrail system. Regardless of who takes over Conrail, we are convinced that the vital economic interests of the region require that any purchaser must be able to demonstrate the following:

1. A long-term strategic commitment to staying in the railroad industry;
2. Adequate corporate financial resources and managerial ability to weather future downturns in the economy;
3. A management commitment to innovative marketing;
4. A long-term commitment not to break up or sell off the railroad after the purchase, Conrail already having had adequate opportunity to trim unproductive lines and increase plant productivity;
5. A commitment to restrict dividends, if necessary, so as to continue Conrail's high level of investment in physical plant and equipment;
6. An openness to competitive options which do not threaten the purchaser's viability and which are of clear benefit to shippers;
7. A continued commitment to the marketing and growth of rail intrermodal traffic, this region's single largest type of railroad traffic; and,
8. A commitment to honor current agreements, understandings and working relationships between the Port Authority and Conrail after the sale.

In addition, with respect to import/export traffic, we will insist on the following from whoever is to operate Conrail:

1. A commitment that the rate charged is consistent with the rate at the railroad's other ports, using conventional piggyback equipment;
2. A commitment to encourage growth of the Port of NY/NJ through innovative pricing schemes, including giving lower rates to high volume shippers;
3. A commitment to further encourage growth of import/export traffic by introducing innovative new services and technologies, such as double-stack cars, designed to capitalize on our port's high volume of container traffic and excellent rail access and clearances; and
4. A commitment not to favor another port or to unfairly cause a diversion of traffic from the Port of NY/NJ through rate settings and services, for reasons other than demonstrable economic and business factors.

These are the points which we urge this committee and every member of Congress interested in preserving the health of this port and its significant contribution to the region and the nation's economic vitality to use as guidance in considering the various options before the Congress. These requirements constitute the minimum criteria which we believe must be met by any bidder before serious consideration is given.

We urge the Committee to not act precipitously, but rather to allow sufficient time to fully explore the options and enable those of us in the Northeast who will be most affected by the sale to assess the potential impacts and consequences. We do not believe there is any clear-cut choice. Each option offers advantages and disadvantages which should be openly aired and weighed. A number of questions have been raised regarding the Norfolk Southern proposal, in particular the nature and extent of antitrust immunity, the anticompetitive impacts, and the potential for traffic diversion from northeastern ports. These questions have not yet been satisfactorily resolved. While we have questions about the public stock offering proposal put forth by Conrail's management in January, we believe that its advocates should be given a reasonable amount of time to come forward with a viable proposal with investor commitments, as we understand Morgan Stanley is presently attempting to do. Should they succeed in putting together such a package, then the advantages and disadvantages of that alternative should be considered alongside those of Norfolk Southern's proposal.

We are continuing our discussions with Conrail and with Norfolk Southern, two extremely capable companies, as well as with shippers and representatives of the States of New York and New Jersey. We will continue to be active throughout the Congressional deliberations and look forward to supporting one or more of the sale options, and a successful transfer to the private sector, when we believe the essential needs of the Port of New York/New Jersey have been fully addressed.

STATEMENT OF W. WILSON GOODE, MAYOR, CITY OF PHILADELPHIA

I am pleased to submit testimony for the Senate Commerce, Science and Transportation Committee hearings on the proposed disposition of Conrail by the Federal Government. The focus of my testimony will be the City's interest in, and concerns over, the sale.

First, I want to commend your committee and its House counterpart for the prompt hearings on this matter. At the same time; however, I believe that Congress should give the question of the disposition of Conrail very deliberate attention. I recognize that there is a consensus, and I concur with it, that the federal budget deficit for the coming year, fiscal year 1986, should be reduced, and that the inclusion of at least $1.2 billion from the sale of the federal interest in Conrail would be a significant contribution toward that goal.

Your decision on how and under what terms and conditions Conrail is to be sold will have momentous ramifications in terms of transportation, commerce and employment as it affects not only the City of Philadelphia and the region directly served by Conrail, but also the national transportation system.

CORPORATE HEADQUARTERS

Today Conrail operates over 14,200 miles of rail service in 14 states and the District of Columbia, connecting with almost all major rail systems in the South and West. It furnishes direct employment for 39,000 workers, spurring additional employment and commerce nationwide.

Philadelphia'a first concerns are, understandably, local Conrail service, including its critical significance to the Port of Philadelphia and coal shipment operations there, Conrail headquarters' operations and the approximately 7,000 Conrail jobs directly associated with these activities. The location of Conrail's corporate headquarters in Philadelphia is actually a requirement of federal law. The 1973 Regional Rail Reorganization Act, which created Conrail, states: "The principal office of the Corporation (Conrail) or of its principal railroad operating subsidiary shall be located in Philadelphia in the Commonwealth of Pennsylvania."

The legislation history of this provision reveals that it was enacted "to guarantee maximum re-employment opportunities for office workers of two of the defunct carriers (from which Conrail was formed), the Penn Central and the Reading." Further, the specification of this location was contained in both the House and Senate versions of the legislation.

Clearly, therefore, Congress has set a precedent for a federal requirement that the corporate headquarters remain in Philadelphia—precisely because of the legitimate Congressional concern over the fate of the headquarters' employees.

The recommendation recently announced by the Secretary of Transportation for Norfolk Southern to purchase the federal interest in Conrail is understood to contain several convenants, among them a requirement that the buyer "maintain Conrail's Philadelphia Offices."

Frankly, I am skeptical over the meaning of this convenant. However, what is of greater concern to me is what happens when the convenant is no longer enforceable. This convenant would remain in force for only 5 years as would all of the covenants which Transportation Secretary Dole announced. Since it will take 2 to 3 years, and probably longer, for Conrail to be fully absorbed by Norfolk Southern, I'm not sure how much security is actually provided by this convenant.

My concern grows even greater when I am told that Norfolk Southern employs only 160 workers at its own corporate headquarters in Norfolk. It has been suggested that the purchase of the federal interest in Conrail by Norfolk Southern will at the outset result in 2,350 lay-offs from Conrail's 39,000 employees. Even if these initial lay-offs do not include employees at Conrail's Philadelphia headquarters, it is hard to believe that this consolidation won't result in future layoffs in Phiadelphia.

These lay-offs would be contrary to the federal policy established by the Regional Rail Reorganization Act. Furthermore, it is unclear what Norfolk Southern's long term plans are regarding future headquarters. When Robert Clayton, Norfolk Southern's Chairman, was asked about the possibility of moving the 160 employees to join the 4,500 office workers in Philadelphia, he light heartedly replied that he would be retiring in two years and would have to leave that decision to his successor!

I understand the vein in which this comment was made; however, there is a reality to it that makes it difficult for me to secure much assurance from the covenant or the present Norfolk Southern position. A continuation of the statutory commitment to retain Conrail's corporate headquarters in Philadelphia would be an assurance that our community's rail workforce and its economic contributions will be maintained, and that any corporate responses to future circumstances or prospects would take the Philadelphia area's needs into account. Such an assurance is crucial for the workers currently employed by Conrail in Philadelphia, for our local shippers and for shippers elsewhere who are served by Conrail service and facilities in Philadelphia.

Let me stress, that I support the decision to return Conrail's rail services to the private sector. However, Congress must keep in mind the intent of the Rail Reorganization Act. Obviously, when Congress decided to take over the operation of the bankrupt railroads that became Conrail, it did so because rail service is an important part of this nation's transportation service. Furthermore, when Congress substantially amended the Act in 1981, it understood the legitimate concern of the employees of these Philadelphia-based railroads and reaffirmed that the headquarters of the new government railroad be located in Philadelphia.

I urge Congress to legislatively protect the intent of the 1973 Act by assuring the continued operation of a Philadelphia headquarters and, equally as important, the continued operation of railroad cargo service.

If there is a question regarding the profitability of maintaining Conrail's corporate headquarters' workforce, the response can be found in Conrail's record of profitability under its current management—over $1 billion in profits in the past four years. Conrail's years of profitability—$39 million in 1981; $174 million in 1982; $313 million in 1983; and $497 million in 1984—belie any allegations that federal policy for the security of its headquarters' employees would be mistaken.

Beginning with the 1973 Regional Rail Reorganization Act through rail deregulation in 1980 and the Northeast Rail Service Act in 1981, a major focus of the federal interest in rail services has been the fate of railroad employees.

I do not believe Congress is inclined to countenance covenants which are tantamount to massive pink slips with five years notice. The well-established federal interest in this matter will certainly endure beyond that time.

The effect of the 5-year expiration of the covenant with respect to the location of Conrail's corporate headquarters in Philadelphia would be to repeal a federal law which has already been on the books for more than a decade. Because the purpose of the law was to implement the federal interest with respect to rail employees and the economy of the Philadelphia region, this result would absolutely forsake that interest. Furthermore, after the federal government no longer has a direct financial interest in Conrail there would be less reason for Congress to consider these matters again.

RAMIFICATIONS FOR PHILADELPHIA'S ECONOMY

The 7,000 workers Conrail employs in Philadelphia are my immediate concern. Any sharp reduction in this workforce would seriously and directly affect our local economy.

Other ramifications could be even more adverse in future years.

In truth, the people employed through rail operations and the economic contributions these operations make to our community are interrelated. Conrail's profitability demonstrates that it is not over-loaded with personnel, but its contribution to our region's economy is far more substantial than its direct payroll.

With regard to the economy, for example, Conrail's coal pier in Philadelphia has undergone major renovations, backed by a $22.6 million loan from the Commonwealth of Pennsylvania. These improvements have increased its handling capacity from 2 million to 10 million tons.

Despite the decline in oil prices, which has reduced the demand for coal, and increasing competition from other coal markets, the efforts to improve the Conrail coal pier have paid off. Its coal exports in 1984 have increased by 5 percent over a nine month measured period in 1983, an improvement to 877,063 tons.

I must ask, what the fate of operations like the Philadelphia coal pier will be if Conrail becomes a part of Norfolk Southern. Will Norfolk Southern "maintain" the operation of facilities like the Conrail coal pier, or will it naturally gravitate toward operations closer to its homeport? I believe this is more than a parochial interest on my part. Competition is in the federal interest insofar as it brings costs down and makes U.S. exports more competitive in world trade.

The City of Norfolk will naturally continue to try to enhance its competitive position for coal exports against Baltimore, Philadelphia and other cities but, as a matter of federal interest for all states, we must judge whether absorption of Conrail by Norfolk Southern will unduly influence the outcome of this competition. The legitimate corporate interests of Norfolk Southern could well be different than the national and regional interests. I believe Congress has a responsibility to take the national and regional interests into account.

OUR RESPONSIBILITIES

The decision over the disposition of Conrail must be made by you and your colleagues in the House. I believe that this decision should be made forthwith but, with so much at stake, it is a decision which must he made only after careful deliberation.

Mr. Chairman, almost $7 billion has been spent by the U.S. Treasury for Conrail. None of the sale proposals you are considering would repay that sum in full. Thus, I believe there remains a strong federal interest in Conrail's sale, and that the Congress should preserve the intent of the Act establishing Conrail.

Thus far, I have addressed only the recommendation of the Administration and the protections I would want to see legislated if in fact Norfolk Southern were to be the Congressionally designated buyer. I wish, at this point, to state for the record that I am open to all of the sale proposals, including the pubic offering proposal put forth by the Conrail Management, assuming my concerns and the federal interest are addressed. Indeed, Conrail's proposal is of special interest to me, as they are the "home team" and a known quantity for Philadelphia's future. Further, I encourage you to consider the option of a public offering in your decision making process.

Whatever your recommendation, I strongly urge you to probe into the disposition proposals to determine their prospects for the next decade and beyond. The lifeblood of the industrial and commercial vitality of the northeast will depend on our abilitly to move goods and people throughout the region in an efficient manner. Thus, our regional transportation system will become more interdependent than ever before with greater opportunity for national and international trade. Conrail, to be competitive in that environment, must be, in my opinion, more than a regional railroad. It must be a part of the major transportation system encompassing rail, air, truck and waterborne transportation. I cannot stress enough the need to know what are the plans for Conrail's future, wherever the control may ultimately reside.

CONCLUSION

Today, I have not only spoken about Philadelphia's strong interest in the disposition of Conrail, but also about the federal interest your committee and the Congress must assess to prudently decide this matter. This federal interest includes Philadelphia's and, as I have noted, federal law has made the two the same for more than a decade.

I believe that Philadelphia's interest and the federal interest can and should remain the same. Now that the Department of Transportation has made its recommendation and the matter is before Congress, I pledge my cooperation with you in reaching a prudent final decision as quickly as possible.

I must conclude by emphasizing that the federal interest we have under consideration is much more than a more dollar sale. Rail workers, shippers and their communities remain a part of this federal interest, as do consequences for our national and international economies. We mush look as far as we possibly can into their futures as the real federal interest, beyond today's statistics and the obvious attraction of a $1.2 billion sales receipt, to make a one time reduction in the federal deficit.

In summary, I ask that you consider four fundamental concerns of mine: preservation of Conrail's headquarters in Philadelphia; maintenance of the Conrail job base in Philadelphia; the future financial stability of Conrail and finally, the fundamentals of a transportation network for the northeast portion of this country for the next several decades.

STATEMENT OF ALLEN E. KINTIGH, SENIOR VICE PRESIDENT OF NEW YORK STATE ELECTRIC & GAS CORP. AND PRESIDENT OF SOMERSET RAILROAD CORP.

INTRODUCTION

My name is Allen E. Kintigh. I am Senior Vice-President—Generation of New York State Electric & Gas Corporation ("NYSEG"). I am also the President of Somerset Railroad Corporation ("SRC"), a wholly owned subsidiary of NYSEG. I am submitting comments on behalf of both corporations, concerning the recent selection by the United States Department of Transportation of Norfolk Southern as its preferred purchaser for Conrail.

HISTORY OF NYSEG'S RELATIONSHIP WITH CONRAIL

NYSEG is an investor owned public utility serving over 800,000 customers in New York State. In August of 1984, NYSEG completed construction of Somerset Station, a 625MW coal-fired generating station, located on the shore of Lake Ontario in Niagara County, New York (Somerset Station).

Somerset Station uses over 1,500,000 tons of coal annually, 100 percent of which is delivered by Conrail. Additionally, as the only coal-fired generating station in New York State equipped with a flue gas desulfurization system, Somerset Station uses 150,000 tons of limestone per year. All of NYSEG's limestone shipments are also delivered by Conrail. NYSEG's expenditure of approximately $17,000,000 per year on coal and limestone rail transportation for Somerset Station, makes it one of the largest shippers in western New York.

The Company uses a quality of coal which is available primarily in specified areas of southern Pennsylvania and northern West Virginia. To determine the most effective, efficient and economic mode by which NYSEG could move the coal and limestone to Somerset Station, NYSEG, prior to constructing Somerset Station, considered transportation by rail, truck, barge, conveyor, coal slurry pipeline, and combinations thereof. NYSEG hired consultants to evaluate each of these alternatives, and all agreed that rail transportation would be the best choice provided a reasonable rate could be obtained.

NYSEG formed SRC for the purpose of constructing, maintaining and operating a 15.5 mile rail line ("SRC Line") which runs from Somerset Station to a connecting point on the Falls Road Branch Line ("Falls Road Line") located near Lockport, New York. The Falls Road Line is owned by Conrail.

SRC received a Certificate of Public Convenience and Necessity from the Interstate Commerce Commission in the Spring of 1982 to operate as a common carrier, and construction of SRC's Line was completed in the Fall of 1983. During the Interstate Commerce Commission hearings, it was determined that rail transportation was the only feasible means of moving coal and limestone to Somerset Station. A map showing the location of the Falls Road Line, SRC's Line and the route of the movement of coal from Buffalo to Somerset Station is attached as Exhibit A.

As Conrail owned lines extending from possible mine sources up to and including the Falls Road Line, NYSEG opened discussions in 1980 to obtain a long-term transportation contract, pursuant to the newly enacted Staggers Rail Act. During the period of 1980 through 1982, NYSEG's meetings with Conrail were unproductive inasmuch as NYSEG found that Conrail was unwilling to quote even a remotely reasonable freight rate.

During the same period, negotiations were also conducted with other rail carriers which could deliver the quality of coal required by NYSEG for Somerset Station. All of these carriers informed us that because Conrail owned all of the rail lines from the Buffalo area to Lockport, Conrail, as destination carrier could effectively control the rate for the movement of coal from the mine sources to Somerset Station.

During 1980 through 1982, NYSEG and SRC also looked at various alternatives for either providing competitive coal delivery on the rail lines from Buffalo to Somerset Station or ensuring that a reasonable rate could be obtained from Conrail. These alternatives included, among others, (i) obtaining trackage rights so that rail carriers other than Conrail could deliver coal to Somerset Station, (ii) obtaining access to the Buffalo terminal facilities or switching district for the same purpose, or (iii) filing a complaint with the Interstate Commerce Commission as to the rates quoted by Conrail.

The drawback to all of these alternatives was the uncertainty of the outcome and the time that it would take to obtain a binding and favorable result. In order to meet its commercial operation date, coal deliveries to Somerset Station had to commence by the end of 1983 so that sufficient coal would be available to begin start-up testing in the Spring of 1984.

When NYSEG and SRC approached Conrail again in 1983, we were informed that this was a "new" Conrail, ready to do business. We were surprised and impressed by the cooperation which they gave us, and by their ultimate agreement to a 14 year coal transportation agreement which contains a freight rate which we consider fair and reasonable. In addition to this coal transportation agreement, Conrail and NYSEG entered into a short term limestone transportation agreement. Conrail and SRC also entered into an agreement whereby SRC granted Conrail trackage rights over a portion SRC's rail line and a separate operating agreement, whereby Conrail agreed to provide equipment, personnel and other necessary services to provide operation and service on SRC's Line. All of these agreements have operated to the benefit of the parties and NYSEG's ratepayers.

IMPACT ON NYSEG AND SRC BY SALE OF CONRAIL TO NORFOLK SOUTHERN

At the time of our discussions with Conrail, NYSEG was able to negotiate effectively for at least two reasons. The final coal sources for Somerset Station had not been determined and, therefore, there was a potential for competition on the long haul between the mine and Buffalo. Thus, even though Conrail, as destination carrier, could have received a large division of the rate if another carrier had transported the coal to Buffalo, NYSEG believes that Conrail wanted to boost its revenues as much as possible and was therefore willing to negotiate a reasonable rate to obtain the entire haul. Furthermore, NYSEG believes that Conrail wanted to impress shippers with its rates and service in anticipation of its sale. Had these factors not been present, NYSEG is of the opinion that despite its size, and the volume of its coal and limestone shipments, it would have had limited bargaining power to negotiate reasonable contracts with Conrail.

Under certain circumstances, the contracts negotiated with Conrail may be terminated. NYSEG is concerned that a sale of Conrail to the Norfolk Southern will result in such a termination. Therefore, NYSEG believes that if Conrail is sold to the Norfolk Southern, it is imperative that competitive rail transportation be provided from Buffalo to Lockport, New York. Failure to provide additional rail carriers with access to Lockport, would result in NYSEG and the other small shippers located in this area being completely captive, with limited or no ability to negotiate reasonable rates with the Norfolk Southern or any other monopoly carrier.

It must be emphasized that the major difficulty in negotiating the contracts with Conrail was that Somerset Station was completely captive to Conrail from Lockport to Buffalo. NYSEG has five other coal-fired stations; three of which receive deliveries via Conrail, but unlike Somerset, these stations are capable of receiving a portion of their deliveries by truck. The truck option at the other stations foster competition. Trucking is not an option at Somerset due to longer haul distances, larger traffic volumes and environmental constraints.

Additionally, since Somerset Station is now in operation, NYSEG no longer has an extended period of time to negotiate with rail carriers, because coal and limestone shipments to Somerset Station cannot be interrupted. If NYSEG is a captive shipper, this further limits NYSEG's ability to negotiate reasonable rates, and could adversely affect NYSEG's ratepayers.

Competition would be provided by granting trackage rights to SRC from Lockport to Buffalo, or by providing rail carriers in addition to the Norfolk Southern, with trackage rights from Buffalo to Lockport. Alternatively, competition could be established by requiring any rail company purchaser of Conrail to enter into reciprocal switching agreements for the benefit of NYSEG and SRC with other carriers that terminate in Buffalo.

In reviewing the possible sale of Conrail to the Norfolk Southern, the Department of Justice stated that such a merger would have a "significant adverse affect on competition" in the Buffalo area. Clearly the Justice Department wants to preserve the beneficial effects of competition in the Buffalo area, and for this reason has stated that it would oppose the merger unless provisions were made to provide for a competitive rail market place in the Buffalo area. Failure to provide for competition from Buffalo to Lockport will significantly increase the anti-competitive nature of this merger, not only for NYSEG, but for the other smaller shippers which are served by Conrail in the Buffalo-Lockport area.

It must be emphasized that NYSEG is not seeking regulatory protection or favored treatment, but rather the ability to negotiate in an open competitive environment. If competitive access to Lockport is established, either through a grant of rights to SRC or to other carriers, in addition to the Norfolk Southern competition would exist for the entire coal and limestone haul. NYSEG is of the opinion that if true competition exists, it will be able to negotiate a fair freight rate for its coal and limestone purchases and better service ratepayers.

NYSEG AND SRC SUPPORT A PUBLIC SALE OF CONRAIL

If no significant competitive protection between Buffalo and Lockport is to be part of the sale to the Norfolk Southern or any other rail carrier, a public sale is required. NYSEG and its ratepayers, would benefit by a public sale of Conrail. Such a sale would keep our relationship with Conrail intact and ensure the continuation of what has been a successful and profitable arrangement for Conrail and NYSEG .

CONCLUSION

If Conrail is sold to the Norfolk Southern or any other rail carrier it is imperative that provisions be made for competitive rail service between Buffalo and Lockport, New York.

If no provision is made for competition, NYSEG and SRC urge that Conrail be sold to the public. NYSEG has been pleased with Conrail's performance under its agreements and would welcome doing business with Conrail as an independent publicly owned rail carrier.

STATEMENT OF JOHN L. OBERDORFER

Mr. Chairman and Members of the Committee. My name is John L. Oberdorfer of Patton, Boggs & Blow in Washington, D.C., and I present this testimony on S. 638, the Conrail Sale Amendments of 1985, on behalf of the Committee of Railroad Shippers (CORS). CORS is a coalition of large bulk and merchandise shippers which depend heavily upon Conrail service. Its members are Allied Corporation, Detroit Edison Company, E.I. Dupont de Nemours & Co., General Motors Corporation, and United Parcel Service. CORS organized early in 1984 to address the need to maintain the competitive transportation environment, service levels and standards that Conrail has been developing in the Northeast and Midwest over the last several years. Today, CORS is neither endorsing nor opposing the sale of Conrail to the Norfolk Southern Corporation, but rather is urging the Congress to incorporate in the transfer legislation a number of provisions we believe are essental to the maintenance of rail competition in the Conrail region.

GENERAL POLICY POSITION

Since the Department of Transportation (DOT) first began to explore the sale of Conrail, the CORS group has expressed interest and some concern about the ultimate content of legislation to effect the sale. Of foremost importance to CORS is adoption of certain shipper protections in either or both the Contrail transfer legislation and the "Definitive Agreement" (contract for sale) between the ultimate purchaser and DOT. Specifically, we recommend changes in these important documents to address the following common interests of shippers: (1) maintenance of a competitive transportation environment; (2) viability of Conrail and other competing carriers in the Northeast and Midwest regions; (3) protection against abrogation of Conrail-shipper contracts and other agreements; (4) preservation of existing service levels and standards established by Conrail; (5) continued access to gateways; and (6) shipper rights to enforce certain shipper-related convenants in the Memorandum of Intent and Definitive Agreements. While CORS supports a transfer of Conrail to the private sector, it cannot endorse S. 638 without provision for these shipper protections.

II. SPECIFIC LEGISLATIVE RECOMMENDATIONS

The Conrail transfer legislation has been submitted to the Congress for review pursuant to the 1981 Northeast Rail Services Act Amendments (NERSA) to the Regional Rail Reorganization Act providing for the sale of the United States Government's common stock holdings in Conrail.

In view of the U.S. Government's substantial ownership interest at stake, CORS believes that it is appropriate to include certain provisions in the transfer legislation that would not necessarily be applicable to other railroads in other transactions. Specifically, the five provisions, discussed below, should be included in S. 638.

A. PURPOSES CLAUSE ON COMPETITION

The purpose of any Conrail transfer legislation is to carry out the provisions of NERSA regarding the sale of the U.S. Government's common stock holdings in Conrail. Accordingly, it is appropriate that the transfer legislation reflect some of the more important directives of NERSA. CORS recommends an amendment to the "Purposes" clause of the transfer legislation stating that among its purposes is to assure the preservation and enhancement of rail competition in the Northeast and Midwest consistent with the needs of such service areas.

B. PROHIBITION AGAINST CONTRACT ABROGATION

CORS believes that the primary substantive deficiency of the transfer legislation is the absence of any provision prohibiting contract abrogation. Many of our members have long-term contracts with Conrail, the terms of which must survive any transfer. The testimony of several witnesses, including those for DOT and Norfolk Southern, have stated that Conrail contracts would be assumed if Conrail were sold to an independent entity. However, the revised Memorandum of Intent contains no provision addressing he assumption of existing Conrail contracts approved pursuant to the Staggers Act. Therefore, CORS is preparing an amendment to the transfer legislation to ensure that such contracts are honored, and we would like to submit the amendment for your Committee's review.

C. CONGRESSIONAL APPROVAL OF THE DEFINITIVE AGREEMENT

In view of the substantial Government investment in Conrail, CORS believes that the Congress should have the right to review all key documents related to Conrail's sale and the subsequent performance of the railroad. The first of such documents are the Definitive Agreements between the purchaser of Conrail and DOT which will implement the Memorandum of Intent. As currently drafted, the transfer legislation contemplates Congressional review of only the Memorandum of Intent, not any of the Definitive Agreements. It is presumed that all of the convenants and other particulars of the draft Memorandum of Intent will be incorporated into the Definitive Agreement constituting the final contract of sale. However, the Memorandum states that it is not binding on the parties and indicates only that such Definitive Agreement will follow the Memorandum only to the extent possible. To ensure appropriate Congressional understanding and review of all the crucial decisions related to the Conrail transfer, the Definitive Agreements should be reviewed by the Congress before they are executed and take effect.

Other key documents that should be subject to some form of Congressional review are the "Compliance Certificates" which the Memorandum of Intent requires to be submitted to DOT periodically by Conrail's purchaser. CORS recommends that these certificates be submitted to the principal jurisdictional committees—the Senate Committee on Commerce, Science and Transportation and the House Committee on Energy and Commerce—for review. Furthermore, CORS recommends that notice of submission of each Certificate be published in the Federal Register and a copy of the Certificate made available to the public. Thus, both the Congress and interested shippers and other groups would have an opportunity to monitor the railroad's operation. In particular, shippers would have adequate notice of the railroad's activities that might give rise to assertion of certain rights or claims, as discussed in the next section.

D. ENFORCEABILITY OF CERTAIN SHIPPER-RELATED COVENANTS

Last summer, CORS reviewed DOT's draft transfer legislation, the Conrail Sale Amendments of 1984, and the July, 1984 draft of the Memorandum of Intent. On September 26, 1984, CORS expressed its views on these documents in a letter to John Riley, Administrator of the Federal Railroad Administration. A copy of that letter is attached for the Committee's information. Among the views expressed in that letter was the need for a legal mechanism in the transfer legislation to enable shippers to sue to enjoin violation of the covenants in the Definitive Agreement (contract of sale) that affect shippers. Although the drafts of the transfer legislation and Memorandum of Intent authorized DOT to seek injunctive relief against a covenant violation, CORS' letter recommended that DOT amend its proposed legislation to give private parties legal means for redress.

Contrary to CORS' request, however, DOT did not include in either the transfer legislation or the revised Memorandum of Intent any provision permitting a shipper to enforce any shipper-related covenants in the Memorandum of Intent or the Definitive Agreement constituting the contract of sale. In fact, the revised Memorandum of Intent, section 16(c), explicitly excluded the assertion of rights and claims by third parties.

CORS recommends deletion of section 16(c) of the Memorandum of Intent, so that shipper-assertion of such rights and claims is permissible. In addition, we recommend amendment of the transfer legislation to provide shippers the affirmative right to seek injunctive relief against violation of any specific covenants in the Memorandum of Intent or provisions of the pertinent Definitive Agreement that affect shipper interests.

To remedy another potential deficiency in the Memorandum of Intent, CORS urges rigorous Congressional scrutiny of section 16(c) of the revised Memorandum of Intent which permits the Secretary of Transportation to waive covenants in the Memorandum. Since very little attention has been focused on this waiver provision thus far, at a minimum DOT should be required to explain in detail during the legislative process the circumstances in which it envisages use of such waivers. Beyond that, CORS recommends one of two alternatives. The first would be a legislative amendment to require an opportunity for public comment on Conrail's purchaser's request for a waiver before such waiver is granted by the Secretary. In the alternative, CORS recommends that legislation bar waivers of covenants altogether.

E. MAINTENANCE OF SERVICE LEVELS AND STANDARDS

As early as September, 1984, when CORS advised the Federal Railroad Administration of its concerns about the draft transfer legislation and Memorandum of Intent, we raised specific questions regarding the meaning and intent of the covenant on maintenance of service in section 12(a)(ii) of the draft Memorandum. That section required the purchaser of Conrail "to maintain the maximum level of rail service throughout its system that is economically sustainable * * *" At that time, CORS recommended that the content of this obligation in section 12(a)(ii) be stated in greater detail.

Unfortunately, the revised Memorandum of Intent has narrowed, rather than expanded, the maintenance of service obligation as well as the definition of such obligation. Specifically, the revised Memorandum states in section 12(a)(ii)(1) that Conrail's purchaser must "maintain rail freight services throughout its system that are economically justifiable * * *" CORS, therefore, urges the Congress to incorporate in the transfer legislation the language originally contained in section 12(a)(ii) of the July, 1984 draft Memorandum of Intent.

III. CORS CONCERNS ABOUT CONTINUED RAIL COMPETITION IN CONRAIL TERRITORY

Of most immediate concern to this Committee, and certainly to the members of CORS, is the assurance that any disposition of Conrail will not reduce or eliminate healthy rail-to-rail competition in the Northeast and Midwest. CORS' position on the competitive issue is well established. In its first letter to DOT dated July 17, 1984, the CORS group made the following statements:

"[W]e believe the most important competitive issue is whether [DOT's] selection will result in the elimination of gateways, the termination of reciprocal switching agreements, and the cancellation of competitive joint rates. Therefore, we urge the sale be made with legally binding provisions assuring access to major markets by more than one carrier through trackage rights, reciprocal switching agreements, joint ownership of appropriate belt and terminal systems, or other means."

The recent Department of Justice study of the potential anticompetitive impact of Conrail's sale to the Norfolk Southern Corporation was an essential first step in the scruitinizing review process necessitated by Conrail's sale to any single major railroad. Many CORS members completed questionnaires issued by the Department.

At this point, CORS believes it would be helpful to a full evaluation of the competitive issues under discussion if the valuable information developed by the Justice Department were disclosed to the Congress and the public. This would permit independent analysis of some of the competitive issues that were examined by the department and others that were not addressed as fully. These issues include identification of the rail lines that would be affected by the divestiture remedy proposed by the Department, consideration of other remedies (e.g., gateway access, reciprocal switching, joint trackage rights, etc.), and the impact of the proposed Conrail-Norfolk Southern merger on shipments of two of Conrail's importan commodities—coal and chemicals. Since several CORS members have substantial coal and chemical shipments in the Conrail region, some bidders for Conrail presented studies to CORS on the potential impact that their acquisition of Conrail would have on these important commodity shipments. We believe Congress should have the benefit of a fuller analysis of the future environment for coal, chemical and other important commodity shipments in the region, whether in a Justice Department supplement to its report or in an independent study of the proposed transfer.

It is CORS' understanding that a number of additional steps have been taken recently to develop this type of information. For example, Chairman John Dingell of the House Committee on Energy and Commerce has written a lengthly letter to the Department of Justice asking a series of detailed questions about the competitive effects on the transfer. The responses, if timely provided, should significantly amplify the information already made available by the Department. In addition, we understand that Chairman Dingell has requested the United States Railway Association to undertake an independent study of the competitive aspects of the proposed Conrail sale. In CORS' opinion, these steps will help develop the information needed for the proper assessment of the competitive environment in the Midwest and Northeast after Conrail's transfer.

It must be remembered that the Congress established NERSA's Conrail transfer procedures as a substitute for an Interstate Commerce Commission (ICC) merger proceeding. In such a proceeding, the ICC must consider, for example: (i) the effect on the adequacy of transportation to the public; (ii) the effect of including, or failing to include, other rail carriers in the area involved in the proposed transaction; and (v) the effect on competition among rail carriers in the affected region. 11 C.F.R. § 1180.1(b)(1) (1984).

In addition, the ICC requires submission of a substantial amount of supporting information (see 11 C.F.R. § 1180.6), market impact analyses (see 11 C.F.R. § 1180.7), and extensive operational and financial information (see 11 C.F.R. §§ 1180.7, 1180.8).

According to Justice Department statements, its study conformed to the requirements of an ICC merger analysis. Part of such an ICC proceeding, however, is the public availability of much of the information submitted. To the extent possible, Congress should ensure that its record on this issue includes the important details of Conrail's transfer before it acts on S.638, rather than accept the legislation as is, with the details to be worked out afterwards.

In sum, more information must be collected and reviewed regarding the rail lines proposed for divestiture, and the nature of any pending agreements relating to the future disposition of such lines. As part of this competitive analysis, consideration should be given to the possiblity of encouraging and permitting negotiations for the sale of certain Conrail lines to rail carriers not now involved in such negotiations. We also think equal consideration should be given to cerain measures to ensure continued competition, including, where necessary, access to the gateways, retention and possible expansion of reciprocal switching agreements and joint rates, exploration of additional joint trackage rights, and joint ownership of appropriate belt and terminal systems.

IV. CONCLUSION

To summarize the CORS' position, we believe that the shipper protections we have outlines in this testimony must be included in the pending Conrail transfer legislation for it to have our support. Specifically, CORS urges adoption of amendments to: (1) establish as a purpose of the transfer legislation the preservation and enhancement of rail competition in the Conrail region; (2) prohibit contract abrogation; (3) require Congressional approval of the Definitive Agreement; (4) provide for Congressional and public review of Compliance Certificates; (5) grant shippers the right to enforce shipper-related covenants; and (6) make provisions, where necessary, for gateway access, reciprocal switching agreements, joint trackage rights, or other measures to maintain rail-to-rail competition.

Mr. Chairman, I and the members of the Committee of Railroad Shippers very much appreciate this opportunity to present our views to you today.

Attachment.

STATEMENT OF JOHN J. NEWBAUER, JR., PRESIDENT, RICHMOND, FREDERICKSBURG & POTOMAC RAILROAD COMPANY

Mr. Chairman and Members of the Committee: My name is John J. Newbauer, Jr. and I am President of the Richmond, Fredericksburg and Potomac Railroad Company (RF&P), with offices in Richmond, Virginia (Post Office Box 11281, Richmond, Virginia 23230, Phone: 804-257-3221).

RF&P has been in existence for more than 150 years, and has long been a major participant in the north/south traffic in the eastern part of the United States, serving as a connecting railroad between Conrail (formerly Pennsylvania Railroad and Penn Central Railroad) on the north, and Seaboard System (and its predecessor railroads Atlantic Coast Line and Seaboard Air Line) on the south. This traffic is in large part highly competitive and, when routed through the Potomac Yard Gateway in Northern Virginia, can move between Conrail and points in the south and southeast by way of either RF&P—Seaboard, or by way of Southern Railway. Competition with Southern Railway has long been vigorous. If Norfolk Southern is allowed to acquire control of Conrail, it is obvious that this competition will be severely impacted because Norfolk Southern will insist that the Conrail traffic be preferentially routed via Southern Railway at Potomac Yard (or via Hagerstown, Maryland—N&W). This will have a serious adverse impact upon the RF&P, and will offend antitrust and monopoly concepts.

The relationship of RF&P in a proposed Norfolk Southern—Conrail alignment, and an analysis of north/south traffic have apparently received little consideration to date. RF&P feels it is of such significant importance that its participation in this large proceeding is justified. For the reasons mentioned, RF&P is strongly opposed to the acquisition of Conrail by Norfolk Southern; however, if such acquisition is approved by Congress, then we believe the contract of sale between the United States and Norfolk Southern must include some conditions (in addition to those recently proposed by the Antitrust Division of the Department of Justice in its letter of January 29, 1985 to Secretary Dole), which additional conditions would relate specifically to the RF&P and north/south traffic, and would require generally as follows:

1. That Norfolk Southern—Conrail would be obligated to continue rates and routes on traffic involving Conrail via RF&P through the Potomac Yard Gateway to and from competitive points throughout the south. Such condition would require that RF&P and its connecting railroads to the south be allowed to participate in any rates published, or contracts made by Conrail, on any traffic at the same level of charges and subject to the same rules and conditions as would be applicable if the traffic was routed via Southern Railway to and from Potomac Yard, (or via the Hagerstown—N&W route). Such arrangements should be subject to divisions between Conrail, RF&P and other involved railroads on formula or basis comparable to those presently used.

2. RF&P should be given the opportunity to acquire trackage rights between Potomac Yard (in Alexandria/Arlington, Virginia) and the New York area via the Corridor. In addition, appropriate arrangements should be made, via trackage rights or other suitable means, for the interchange of traffic between RF&P at Potomac Yard and "Prorail" (which has been mentioned in the media), or any other such competitive rail system that evolves from or is created as result of the sale of Conrail, such point of interchange to be at Potomac Yard if possible, or at the closest point at which it is operationally feasible to make such interchange.

The following is offered in justification and explanation of the RF&P position and request for conditions:

RF&P was incorporated in the State of Virginia in 1834, and has had its offices in the City of Richmond and has been functioning as a separate railroad during its existence.

RF&P operates between Richmond, Virginia and Washington, D.C., approximately 110 miles, with a fully signaled, modern, heavy-duty double track mainline. RF&P uses its own locomotives and operates the trains over its line, both freight and passenger. It owns numerous railroad cars, and has approximately 850 employees.

RF&P owns and operates the large Potomac Yard freight classification facility in Arlington and Alexandria, Virginia. This yard is unique in that it provides services for six different railroads through one organization—those railroads are: RF&P, Southern Railway, Baltimore & Ohio, Chesapeake & Ohio, Conrail, and Delaware & Hudson. Each of those railroads operates its own trains in and out of Potomac Yard with its own locomotives, crews, etc.

In the calendar year 1984, the RF&P railway operating revenues as reported in its Annual Report were $57,459,000. A copy of the RF&P Annual Report for the year 1984 is attached to give you further details.

The competitive situation between the RF&P—Seaboard route and Southern Railway on traffic via Potomac Yard to and from Conrail and points in the south and southeast is indicated by the attached small maps from "The Official Railway Guide" showing:

(A) The RF&P (and some of its freight train schedules) and Seaboard System Railroad territories; and

(B) The Southern Railway territory. A quick comparison makes it clear that the Southern Railway and Seaboard territories overlap extensively. They jointly serve numerous major cities throughout the south, and of course have connecting smaller railroads to other locations. From this it should be clear that the routes to and from

Conrail via RF&P (and its connections with Seaboard and others to the south) are very competitive on nearly all traffic with the routes via Southern Railway through Potomac Yard.

Traffic to and from Conrail could also move via the Hagerstown, Maryland—Norfolk & Western route connection with Conrail and to and from points within the southeast, again in vigorous competition with the RF&P route. The route and rate protection requested by RF&P should also cover this possibility.

We can illustrate the vigorous degree of competition by calling attention to specific problems and solutions which have arisen in the past several years. In 1982 Conrail advised RF&P and Seaboard that it was losing $1,200,000 per year on certain traffic moving via RF&P—Seaboard through Potomac Yard and via Seaboard over the Cincinnati Gateway, which traffic might otherwise move via Southern Railway (a preponderance of this traffic is calculated to be moving via Potomac Yard). As a result, RF&P and Seaboard jointly agreed to pay Conrail $1,200,000 per year (which has since been increased) to retain this traffic. In turn, Conrail agreed not to discriminate against RF&P and Seaboard in favor of Southern Railway System in connection with rates or traffic solicitation. Another evidence of the competitive nature of the traffic is that Conrail has published various surcharges, and it was necessary that RF&P and Seaboard enter into surcharge absorption tariffs in order to remain competitive. If RF&P does not have rate and route protection, it obviously will not be able to be competitive if Norfolk Southern acquires control of Conrail.

Illustrative of RF&P traffic to and from Conrail or points north thereof, which is directly competitive with Southern Railway and susceptible to diversion, are paper products, pulpboard, chemicals, and piggyback shipments, representing a substantial portion of RF&P annual freight revenues.

In that RF&P is frequently viewed as an affiliate or subsidiary of CSX, we would like to emphasize that our position here is one taken independently by the RF&P management, in the interest of the RF&P as a separate functioning railroad with over 60 percent of its shareholders having no connection with CSX. Briefly, over 37 percent of the Company's stock is held by the general public, approximately 20 percent is held by the Commonwealth of Virginia, and about 8 percent involves the Southern Railway. CSX by way of C&O, B&O, and Seaboard, owns or controls about 34 percent of our total outstanding stock, which includes control of approximately 60 percent of our voting stock by way of the Richmond Washington Company. The latter was created in 1901 to acquire ownership of the RF&P pursuant to an agreement between the then six interested railroads which were Pennsylvania Railroad, C&O, B&O, Southern, Atlantic Coast Line, and Seaboard Air Line. This resulted in the acquisition by Richmond Washington Company of what is now 62.9 percent of the voting stock of RF&P (voting stock being less than 20 percent of the total shares outstanding, with the rest being called dividend obligations).

As just mentioned, the views of RF&P being here expressed represent the independent position of this separate Company, and should not be considered to be an adjunct of or supplement to the separate and distinct arguments being advanced by CSX. RF&P is not here to take a position on the several other proposals for the disposition of Conrail, but may do so in the future should it become appropriate.

In conclusion, RF&P is opposed to the acquisition of Conrail by Norfolk Southern because of the potential adverse affects upon RF&P through diversion of traffic, and because of the antitrust—monopolistic concepts involved, but if such acquisition by Norfolk Southern is finally approved, then RF&P requests:

1. Rate and route protection; and

2. The opportunity for RF&P to acquire trackage rights between Potomac Yard and the New York area, and, in addition, the opportunity to interchange traffic, via trackage rights or other means, with "Prorail" or any other such competitive rail system that evolves from or is created as result of the sale of Conrail.

Statement of the New York State Task Force

Many of New York State's rail interests have been following the sale of Conrail very closely and have made every effort to monitor the sale process and the issues affected by the Conrail sale. Among these efforts has been the organization of a Task Force on the Sale of Conrail, comprised of approximately 100 representatives of the State's rail dependent shippers and communities, to evaluate the progress and potential impacts from the transfer of Conrail. The Task Force has developed and transmitted to USDOT and all parties involved, its requirements and concerns regarding the sale. The Task force urged the Secretary of Transportation to give full consideration to the following objectives in judging the adequacy of the offers to purchase Conrail. They are:

1. The primary objective of the new owners must be to operate as a railroad in an increasingly competitive environment and the railroad should not be purchased for any short term non railroad purpose, such as tax benefits.
2. Competitive mainline service on major east-west and north-south routes must be continued.
3. Further reductions in the branchline system must be minimized.
4. High and wide clearance routes must not be threatened with downgrading or abandonment.
5. Gateways and interchanges should not be closed nor should there be an increase in joint rates or cancellation of through routes.
6. State and local tax exemptions must be ended.
7. Any prior contractual obligations must be undertaken by the new owner.
8. The sale should be completed in a timely manner.
9. The sale agreement should provide the financial and operational goals of the new owner.
10. sufficient data should be provided to demonstrate that the financial and operational goals of the new owner are achievable.
11. The agreement should provide for consideration of open entry to provide competition, and
12. The sale agreement should provide for repayment to the Conrail states of an amount equal to past deferred taxes.

The Task Force is satisfied that the Secretary's process has satisfactorily addressed most of these concerns, primarily through the requirement of protective convenants.

In addition to the concerns about the sale agreement NYSDOT and the Task Force believe that any implementing legislation should include the following:

1. Provide for a public review and comment as part of the Congressional process for the sale.
2. Insure that the owner be made responsible for all bridges and crossings on active and abandoned lines. Conrail states face millions of dollars of maintenance expenses on the so-called "Orphan bridges" of which Conrail denied responsibility following reorganization.
3. Provide for the return of the sale proceeds to the Conrail states for rail improvement projects, many of which are the orphan bridges referred to above.

We intend to work closely with USDOT, Norfolk-Southern and our Congressional Delegation to identify problems and possible remedies to an NS/CR merger.

The Task Force has identified three major concerns with regard to sale to Norfolk Southern Corp. The first is adequate competitive protection. New York is concerned with the Federal Government's promise of competitive protection. While on one hand, the Justice Department has guaranteed that Norfolk Southern divest itself of one of its mainlines to Buffalo and allow access by other carriers, it is unclear what rights will be given to access rail customers. Another reason we question Federal guarantee is because the ICC has recently granted permission to sell its Canada Southern Railway between Detroit and Buffalo/Niagara Falls and yet maintain restrictive interchange rights which deny access to the purchasing Canadian carrier with other railroads in the Buffalo area. Conrail will retain the ability to act in intermediate interchange capacity and charge a switching fee on every carload entering through the Canada Southern Gateway. Competing railroads must have the ability to access local industry, otherwise competition will be lost. This principle must be developed into a specific plan to be incorporated into any sale agreement.

Another of the Task Force's criteria for the sale is retention of competitive east-west mainlines in the state. Continuation of through-route service on the Southern Tier mainline is essential to meeting this criteria. Under the terms of the Conrail Southern Tier agreement, signed by Chairman Crane in October 1982, New York State may require all or part of the Southern Tier lines and its extentions at the net liquidation value, less the depreciated value of the state's investments of the Southern Tier, in the event Conrail is transferred pursuant to Section 1142 of NERSA. What this means is that upon sale, rail access from both Akron, Ohio and Buffalo to New Jersey over the Southern Tier route could be offered to other carriers at the state's discretion. Unless NS addresses these concerns in detail and in a timely manner, the Task Force will have no alternative but to oppose NS.

On the other hand, we are impressed both by NS managements' approach to this issue and by the potential improvements NS could bring to New York through the re-opening of gateways and interchanges and the efficiencies of through shipments from the south.

The federal government is the majority owner of Conrail. It is essential that the Secretary of Transportation insure the Conrail management provide Norfolk Southern with all information necessary to address issues which are crucial to states, local government and rail users.

We also intend to closely study the financial viability of a public offering of Conrail stock. This effort is merited on the basis Conrail management's capabile efforts to date and as an alternative should Norfolk-Southern's plan be found not to be acceptable. At this time, the specific information required to take any position is not yet available. I can assure you that our findings in these regards will be conveyed to this committee as soon as they are available.

OHIO FARM BUREAU FEDERATION, INC.,
Columbus, OH, February 28, 1985.

Chairman JOHN C. DANFORTH,
Committee on Commerce, Science, and Transportation, Senate Russell Office Building, Washington, DC.

DEAR CHAIRMAN DANFORTH: The Ohio Farm Bureau representing 94,000 family members in Ohio believes the members would be well served if Norfolk Southern Corporation acquires ConRail.

Many of our members are presently being well served by Norfolk Southern in that the raw agricutural products and farm supplies are being transported by this corporation. We believe Norfolk Southern has demonstrated its recognition of the transportation needs of its shippers even though it is not always faced with direct competition.

Norfolk Southern has demonstrated its ability to integrate rail systems and its competence in "running a railroad", thus providing optimum service over the long run.

Our members would be pleased if Norfolk Southen Corporation gets the nod to acquire ConRail.

Sincerely,

DEAN W. SIMERAL,
Vice President, Public Affairs.

STATEMENT OF ROBERT A. WALKER, VICE PRESIDENT,, PLANNING, GRAND TRUNK WESTERN RAILROAD CO.

Grand Trunk Western Railroad Company is a midwestern railroad that will be gravely harmed by the proposed sale of Conrail to Norfolk Southen Corporation. This statement will supplement my previous testimony of February 28, 1985, will summarize the impacts on Grand Trunk and will explain why none of the proposed protective measures will address these injuries. Further, we will explain why injury to Grand Trunk should be of concern to this Committee, to rail shippers and to the public.

In my previous testimony before this Committee, I emphasized the need for an independent agency investigation, which would be conducted prior to final congressional action on the Administration's bill, to address the subject of the adequacy of the divestiture plans announced preliminarily by Norfolk Southen. Hearings conducted in recent days by the Senate Committee on the Judiciary have demonstrated further reasons why an investigation into this and other issues is urgently needed. In response to questions on the propriety of granting antitrust immnity to a transaction that has not undergone the searching scrutiny of a proceeding before the Interstate Commerce Commission (ICC), Assistant Attorney General McGrath testified that further study would be "redundant" because DOT has already performed an "enormously extensive" review of the Norfolk Southen-Conrail consolidation. He was concerned that Congress, if it required further review, would ". . . due process this thing to death. . . ." (Hearing Transcript, March 27, 1985, at 112-14.)

However, at the April 2 hearings Deputy FRA Administrator Rooney made it quite clear that Congress was not in any danger of over studying the transaction. Mr. Rooney stated that DOT has made no independent assessment of the impact of the transaction on employment, facilities, train service or the adequacy of transportation services. DOT has never received or reviewed a detailed operating plan prepared by Norfolk Southen to depict how the combined NS-Conrail system would be operated after the consolidations were fully accomplished. According to Mr. Rooney, the matter has been referred to the Department of Justice and it is his understanding that they will look into it. From Mr. McGrath's testimony, it seems clear that

that will not be the case. Moreover, we question whether the Department of Justice is the appropriate agency or possesses the technical transportation expertise, to make such an analysis.

Grand Trunk believes, with all due respect to this Committee and to Congress, that complicated factual issues in dispute cannot be resolved through the vehicle of legislative hearings. However, United States Railway Association (USRA) and the ICC are capable of making findings on these difficult transportation issues. Grand Trunk renews its request that this Committee stay its hand on the Administration's bill until the end of the August recess. During that interim peroid, it should refer specific questions to USRA and the ICC concerning:

(1) The impacts of the Norfolk Southern-Conrail transaction on other carriers, on employees and on the adequacy of transportation services;

(2) The adequacy of the Department of Justice analysis of the competitive impacts of the transaction; and

(3) The adequacy of the divestiture plans proposed by Norfolk Southen or alternative proposals to adequately offset the anticompetitive impacts of the transaction and to satisfy the criteria for long term viability set by the Department of Justice January 29, 1985 letter.

Two days ago Grand Trunk learned that the Commerce Committee was holding this hearing to inquire into the "impacts of the NS-Conrail merger on Midwestern railroads." This and scores of other important questions relating to the consequences of the merger have yet to receive the consideration they deserve. This Committee cannot hope to fill the gaps through hearings of this nature. We would hope that the referral process we have suggested would be seen as more appropriate way to proceed.

HARM TO GRANT TRUNK

Grand Trunk serves significant shippers throughout Michigan and Ohio that are also served by Conrail, but not by Norfolk Southern. As a result, Norfolk Southern has been a "friendly connection" working in coordination with Grand Trunk to provide service that competes against Conrail's service. In 1983, over 50,000 carloads of traffic fell into this category. This traffic was originated or terminated at such points as Dearborn, Lansing, Grand Rapids and Kalamazoo.

After the merger Norfolk Southern will become competitively hostile and all of this traffic, yielding to Grand Trunk $35 milion in gross revenues in 1983, would be subject to diversion to NS-Conrail with Grand Trunk foreclosed from participation in the business. On the conservative assumption that Grand Trunk would lose only one half of the traffic in this category that that it originates and three quarters of the traffic it terminates, the harm would be a loss of 36,400 carloads and over $17 million of lost revenues.

Last year Grand Trunk had one of its best years in recent history, reporting slightly over $3 million in net income. Losses of the magnitude described will deal a crippling blow to Grand Trunk's viability. The key competitive service which Grand Trunk renders to shippers in this region will be jeopardized by this transaction.

The Department of Justice analysis of impacted markets assumes that Grand Trunk will survive as a viable carrier throughout Michigan and Ohio. However, the Department concedes in its January 29 letters to Secretary Dole that it could not "draw firm conclusions" from the diversion estimates provided to it. Consequently, the results of the market share studies appended to the Justice Department letter do not reflect traffic diversions or impacts on regional carriers. We believe this analysis is deficient and unsupportable.

The Department of Justice speculates about counter-balancing benefits in terms of cost savings that might offset the harm created by traffic diversions. It is clear that the Department had no factual basis to support its supposition. The cost savings attributable to the elimination of a competitor from the routing are minimal at best. When, as in the case of Grand Trunk's route between Detroit and Cincinnati, it forecloses competition over a more efficient joint line route there is no economic justification whatsoever. It is also misleading for Justice to suggest that cost savings will be achieved only as a result of the NS-Conrail merger. Railroads commonly enter into coordination agreements and runthrough train arrangements which realize identical cost savings to those described by Justice, without merging and foreclosing competition provided by other regional carriers.

The harm to Grand Trunk and to competition in our region will not be offset by cost savings realized by NS-Conrail. Grand Trunk's route between Detroit and Cincinnati is the most efficient route—bar none. Withnesses for Norfolk Southern have testified to that effect in proceedings before the ICC. If the NS-Conrail merger occurs, Grand Trunk might just as well rip up the track because there will not be adequate traffic to justify its maintenance. This would be contrary to the public interest and the efficiency of the nation's rail system.

The Department of Justice also speculates about the divestiture plans providing an answer for regional carriers to these diversions. I will now turn to the subject of the adequacy of the remedies proposed by Norfolk Southern.

THE REMEDIES PROPOSED BY NORFOLK SOUTHERN WILL NOT PRESERVE COMPETITION OR PROTECT REGIONAL CARRIERS

Norfolk Southern proposes a series of divestitures which will not preserve competition, and offer no hope to carriers like Grand Trunk which depend upon high speed, time-sensitive service to compete with Conrail, CSX, Norfolk Southern and motor carriers. The proposed divestitures to Guilford and P&LE will not provide an adequate competitive alternative.

To provide effective competition with a giant rail system that will be operating ten to fifteen trains per day in each direction between major cities in certain corridors identified by DOJ, the carriers operating the divested lines must have a strong traffic base and a modern physical plant. The plans offered by Guilford and P&LE fail miserably on both scores, particularly west of Toledo.

Grand Trunk's President, Mr. John H. Burdakin, testified before the Senate Judiciary Committee about the specific inadequacies of these divestiture plans and about alternative plans supported by Grand Trunk which would rectify these problems.[1] Unfortunately, the only plan receiving serious consideration by DOT or the Department of Justice are those offered by Norfolk Southern.

Grand Trunk would be willing to coordinate its services with any system made from divested lines, provides that system is capable of rendering competitive service. Our shippers will not tolerate inferior service, and we would jeopardize our participation in the traffic if we were to promote such routings.

Unfortunately, the present proposals by Guilford west of Toledo will not provide service we can promote. Mr. Mellon testified before the Committee on the Judiciary that Guilford is satisfied to operate a railroad with maximum allowable speeds on its mainline of 40 mph. This will not cut the mustard with merchandise shippers in Michigan and Ohio which insist upon reliable, time-sensitive service.

For some bulk traffic Guilford may be able to provide adequate service. Indeed, the Guilford divestitures would result in additional diversions away from Grand Trunk and would further contribute to Grand Trunk's demise. However, over the long term the divestiture plans are not economically viable and will not compete with NS-Conrail for broad categories of business in the impacted markets.

The Secretary of Transportation has also made much of the covenant contained in the Memorandum of Intent with Norfolk Southern which purportedly preserves competitive access by regional carriers through preservation and reestablishment of joint rates and through routes. As presently drafted the covenant will have no such impact.

First, Grand Trunk is defined to be outside the coverage of the covenant because its operating revenues are in excess of the $300 million maximum contained in the covenant. Even if that deficiency were addressed, the provision would last for only five years and offer no protection thereafter. We can understand no jurisdiction for placing an arbitrary time limit upon the preservation of competition.

Finally, and perhaps most importantly, this provision is so vaguely worded that it is unclear what it means. Conrail management reads its terms as requiring rate equalization over competing routes. Grand Trunk doubts that Norfolk Southern had any such intention, and Grand Trunk does not desire that form of protection. However, we believe that it could be read to prevent regional carriers from instituting competitive rates over routes in which it depends upon Norfolk Southern or Conrail for a portion of the movement.

Even under a properly drafted covenant, indirect access to markets or gateways via a varrier which competes directly with regional carriers will never adequately compensate for the losses to be suffered by those regional carriers as a result of the merger which eliminates a friendly connection to those markets or gateways. Nevertheless, I think that language can be developed which is capable of preserving at least a portion of the competition eliminated by past route closing actions by Conrail and threatened by the merger of Norfolk Southern and Conrail. The covenant suggested by DOT will not do the job, but Grand Trunk is prepared to suggest an alternative ii the Committee indicates the slightest interest in this issue.

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[1] Rather than repeating his remarks, I would like to incorporate Mr. Burdakin's testimony into this record. A copy is attached to this Statement.

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